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GOVERNMENT POLICY AND THE DEFENSE INDUSTRIAL BASE

HEARING

BEFORE THE

SUBCOMMITTEE ON MONETARY AND FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

NINETY-SEVENTH CONGRESS

FIRST SESSION

DECEMBER 9, 1981

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GOVERNMENT POLICY AND THE DEFENSE INDUSTRIAL BASE

WEDNESDAY, DECEMBER 9, 1981

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:10 p.m., in room 6226, Dirksen Senate Office Building, Hon. Roger W. Jepsen (chairman of the subcommittee) presiding.

Present: Senator Jepsen and Representative Richmond.

Also present: William R. Buechner and Chris Frenze, professional staff members.

Representative RICHMOND [presiding]. Good afternoon, ladies and gentlemen. This is a hearing on government policy and the defense industrial base of the Joint Economic Committee's Subcommittee on Monetary and Fiscal Policy. The chairman, as you know, is Senator Roger W. Jepsen. I'll just chair this meeting until Senator Jepsen arrives. I'd like to read Senator Jepsen's opening statement so that we all can put this hearing into context.

OPENING STATEMENT OF SENATOR JEPSEN, CHAIRMAN

This hearing is the second in a series before the Joint Economic Committee on the state of our defense industrial base. The theme of these hearings is industrial preparedness, and it is important to clarify that term at the outset. Defining the many facets of the term "industrial preparedness" while avoiding a useless generality is difficult. It is easier to define "industrial preparedness" in terms of the goals that a proper industrial preparedness strategy should accomplish.

J. S. Gansler, in his book, "The Defense Industry," provides a list of possible goals for our defense policymakers. I would like to quote the author in the following two points that clarify the aims of industrial preparedness, which are:

> To achieve maximum production efficiency, for the long and short term, with the given resources . . . that is going to avoid waste.

Second,

> To provide sufficient surge capability . . . for likely emergencies ranging from proxy wars such as the 1973 Mideast war to various levels of wartime mobilization.

The information provided during the course of these hearings will shed greater light on the meaning of these goals within the context of Government policies.

On September 30, 1981, this subcommittee received testimony from several representatives of capital-intensive industries on the state of domestic industrial base. They expressed a wide range of concerns and did not always agree on what was needed to achieve the aims mentioned above.

One of the themes that ran through their testimony concerned the second industrial preparedness goal: a sufficient surge capacity. It was alleged that current Department of Defense and maritime policies concerning foreign sources to meet requirements were currently eroding our industrial base, especially at the subcontractor level. Many witnesses testified that the firms they represented were being forced to compete unfairly with foreign companies which are often provided with loan guarantees, subsidies, and other assistance by their governments. Thus, we are losing our production capacity in many areas vital to our national security and undermining our domestic surge capability.

This hearing will examine the relationship between Government policies and the industrial base in greater detail. The main focus concerns Government policies regarding foreign sources to meet requirements of defense contracts and the incentives provided to American shippers to buy American-built ships and have ships repaired and refitted domestically. The essential concern is the impact of current policies on our surge capacity in the event of mobilization.

We will be receiving testimony from two witnesses: Hon. Fred Ikle, Under Secretary of Defense for Policy, and Ronald Kiss, Acting Associate Administrator for Shipbuilding and Ship Operations. Mr. Kiss is with the Maritime Administration in the Department of Transportation.

The testimony of these two able officials should provide a better understanding of the administration's perspective on this issue.

Opening Statement of Representative Richmond

Gentlemen, on behalf of the subcommittee, I would like to welcome you and on behalf of Senator Jepsen, of course I'd like to welcome you. Having just read Senator Jepsen's opening statement, I'd like to associate myself with this statement because I certainly believe that everything he said is critically important to our own defense capability.

I have to tell you about the terrible problem we have in the steel industry—and I don't know what our Government can do about it. Here you have U.S. Steel, which we know is badly in need of modernization—the major steel company in the United States. Apparently, they have money because they have $6½ billion to buy Marathon Oil. And we also know that that $6½ billion is about the amount it takes to modernize U.S. Steel.

Now, Congress has voted a special tax benefit for steel companies so that they could modernize. As a matter of defense capability, I don't have to tell you gentlemen how badly we need a modern steel industry. Is our Government going to do anything to keep U.S. Steel from taking $6½ billion of its steel money and investing it into an oil company? Is that why Congress passed enabling legislation to allow the steel industry to modernize?

Mr. IKLE. Good question.

Representative RICHMOND. These are some of the things that bother me, and I'm sure that they bother Senator Jepsen even more.

Mr. IKLE. Right.

Representative RICHMOND. Go ahead, sir, as you wish.

STATEMENT OF HON. FRED C. IKLE, UNDER SECRETARY OF DEFENSE FOR POLICY, ACCOMPANIED BY WILLIAM A. LONG, DEPUTY UNDER SECRETARY OF DEFENSE FOR RESEARCH AND ENGINEERING

Mr. IKLE. Good question, sir. The marketplace doesn't always work on its own, for our purposes.

Mr. Richmond, I appreciate the opportunity to appear before this subcommittee to discuss the Defense Department's needs for industrial readiness. I understand that your particular concerns in this subcommittee are with the impact of foreign sourcing of U.S. defense items on our domestic subcontractor base, and the Defense Department's plans to strengthen the subcontractor base.

Let me assure you, first—and this responds to the illustration you raised about the steel industry—let me assure you that DOD fully appreciates the importance of a strong industrial base to our national defense. An industrial base capable of rapid expansion to support our mobilization and sustain deployed forces is an essential component of our defense posture. And there's no question that such an industrial base can add to the deterrence of war.

We have developed a DOD action plan for industrial responsiveness with three major thrusts: national resources; second, the defense acquisition process; and third, industrial preparedness.

We are seriously concerned about the defense industry—especially with respect to the fundamental strength of the base—its productivity, the quality and reliability of its products, lead time—the lead times of our industry are far too long—diminishing manufacturing sources, and the ability of industry to respond to normal demands as well as surge and protracted emergency requirements.

Now when we speak of the defense industrial base, we refer to that industrial capacity in both the private and public sectors that is necessary to support the military materiel required for our national security.

With the possible exception of the ammunition base, there is no separate, captive defense industrial base. By law, and by this administration's policy, we will rely, to the extent possible, on the private sector of the base to support our national security needs. Although the Department of Defense has a major investment in facilities and production equipment, we largely rely upon the 25,000 to 30,000 prime contractors and numerous subcontractors in the commercial marketplace.

And because the greatest share of the base is the private sector, we must look to profit and business stability as the main incentives for a viable base.

Unfortunately, defense business does not always offer these incentives. The cyclical nature of the defense business, and in the post-Vietnam period, the decreasing defense procurement, have made it

unattractive to many suppliers. Also, we know that there is an excessive burden of U.S. Government regulations acting as a disincentive to many potential suppliers.

Now let me turn specifically to the foreign sector's role in defense production.

A DOD review of critical items in 1977 and 1978 determined that we were totally dependent upon foreign sources for over 120 critical items, most of which were components of end items that would be produced by our domestic subcontractors.

Examples of such items are quite an impressive—or depressing—list: Bearing from Japan for submarines; hydraulic drive motors from Sweden for sonar systems; electron tubes from Sweden.

This review also determined that over 50 percent of our solid state products may, in fact, be foreign-source-dependent on Japan, Sweden, England, and Hong Kong.

We have established policy that directs the services and Defense Logistics Agency to take action when essential production capabilities are endangered by potential loss of manufacturing sources or by material shortages. The emphasis of this policy is on insuring a continued domestic supply of critical items. For example, only in exceptional cases can foreign companies be considered as viable alternatives for new sources, and they cannot be considered where industrial preparedness planning is involved and a foreign source would be the sole source.

An alternative action under this policy is to utilize what we call determination and findings under the Defense Acquisition Regulation—3–316—which require directed procurement to domestic producers in order to preserve the industrial source necessary to meet our preparedness requirements.

The Office of the Under Secretary for Research and Engineering will be updating the last review of critical items within the next 6 to 12 months.

The reasons for our growing dependence on foreign suppliers are varied. In some instances, it stems from the lack of timely responsiveness of domestic suppliers to demands of U.S. industry. For example, lead times on machine tools made in the United States have been excessive. Although recently reduced to an 8-month average, machine tool lead times have averaged 14 months or longer. In fact, the negative balance of trade on these tools first began to show in 1978 and has been increasing each year, so that we now estimate 23 percent of all U.S. machine tool purchases are offshore. A recent illustrative example is a west coast munitions company which received estimates from U.S. tool suppliers of 18 months' waiting time; they were able to acquire the same tool from Japan in one week.

There are other examples of foreign dependence which are simply due to pricing. Domestic cobalt mining ceased at the end of 1979, since world cobalt prices were not high enough to sustain domestic production. The current market price is approximately $9 per pound. Our two potential domestic suppliers would require a market price of approximately $20 to $25 per pound over a sustained period, to justify resuming production.

Productivity changes are also a factor. For example, domestic consumers purchase roughly 16 percent of their annual titanium sponge requirement from Japan, despite Japan's 20-percent higher price. So

in this case, it's not a matter of price. But the reason is that Japanese sponge producers use a vacuum distilling process, which so far has not yet been adopted in the United States. The advantage of the vacuum distilled sponge is that it considerably reduces the costs of processing the sponge into ingots.

DOD must depend, in some instances, on foreign sources as a result of the lack of leverage DOD can exert on the market. For example, it has been estimated that DOD's share of the electronic component market is only 6 percent. The industry, therefore, responds principally to the demands of the commercial sector, which is 94 percent, leaving DOD to seek overseas markets, mostly in the Far East.

This particular case and others similar to it are not of immediate concern because the domestic capacity to produce these products is being protected by the domestic market, and in the event of an emergency, we could direct production to meet DOD requirements; that is to say, the pure statistics may lead one to believe that we have excessive foreign dependence, whereas, in actuality, that would not be the case in an emergency.

Most critics argue that it has been the lack of reliable defense business that has caused subcontractors to seek business elsewhere, or to go out of business. Statements of businessmen before this subcommittee provide good examples. Your witnesses argued that it is the dependence of defense-oriented subcontractors on defense contracts that causes them to lose their technological and market leads to foreign competitors.

In other words, defense business is bad for you.

This is another version of the argument that the Japanese, for example, have gained a competitive edge in some world markets because of their low defense spending which does not crowd out productive investment as does U.S. defense spending. Mr. Richmond, the example you cited before in the steel industry using its money to acquire companies outside of its field, also help to contradict this specious argument from industry.

And the argument was also refuted in their hearings, and I believe correctly so, because there is no reason in principle why the United States cannot design taxes, for example, or other incentives, if needed, to promote the kind of investment desired to raise productivity.

I should point out that we are not against foreign contracting or subcontracting per se. We are aware of our international obligations under the Government Procurement Code of the General Agreement on Trade and Tariffs—GATT—and, in particular, our arms cooperations initiatives in NATO. These initiatives in NATO resulted in 11 reciprocal procurement agreements that we have established with our allies.

In this context, we view foreign competition to be healthy for the strength of the NATO alliance. Our task in DOD is not only to fulfill our international commitments here, but also to exercise sound judgment before restricting certain critical military items from being produced offshore within the NATO alliance.

Representative RICHMOND. Mr. Secretary, I am terribly sorry. I have a vote on the House side on the foreign aid bill. I think your testimony is fascinating and I'll try to get back as quickly as I can. Excuse me.

Mr. IKLE. All right, sir.

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[A brief recess was taken.]

Senator JEPSEN [presiding]. This hearing will now reconvene.

Mr. Ikle, I know that you returned early from a trip to Europe to attend this hearing, which makes it doubly embarrassing for the delay, and I apologize for that. I thank you for your concern, your interest, and the sacrifices you made to be here. Please proceed.

Mr. IKLE. Mr. Chairman, I am pleased to appear before your subcommittee and to testify here on what I consider one of the most important subjects in our defense effort and our effort to strengthen the deterrent capability.

If you wish, I might take just 1 minute to summarize the presentation I made. I suggest we keep it off the record to avoid repetition in the record itself until I get back to the stage where I left off.

[Discussion off the record.]

Mr. IKLE. Now let me resume the testimony, Mr. Chairman, where I left off. I was pointing out that we are not against foreign contracting or subcontracting per se, because of the international obligations we have, the GATT agreement and also our initiatives with NATO, which are reflected in 11 reciprocal procurement agreements.

In this context, we view foreign competition to be healthy for the strength of the NATO Alliance. Here our task is not only to fulfill these international commitments to our allies, but also to exercise sound judgment before we start restricting certain critical military items from being produced offshore. Our industrial preparedness program requires the military departments to identify possible sole-source situations in the United States and dependence on foreign sources.

Another criticism of foreign sourcing has arisen from these "offset" arrangements with the allies, whereby a foreign buyer of U.S. defense goods seeks compensation for its purchase in the United States by getting a part of the production action in their own country, or by selling some of its goods to the United States.

The Defense Department's policy since 1978 has been generally to oppose such arrangements on a government-to-government basis, and the outstanding balance of such offsets has declined. We believe that the magnitude of commercial offset arrangements, however, is growing. The Treasury Department, in collaboration with industry associations, is attempting to determine its size.

Now it's important to keep in mind in this context our two-way trade balances with our NATO allies, because these balances, Mr. Chairman, affect their perception of U.S. cooperation in alliance matters, just as we expect Japanese cooperation on trade issues because of what we perceive to be an inequitable trade balance with the Japanese.

There are three levels to consider here. One, at the aggregate level, the United States, as you know, maintains a healthy trade surplus with our European allies. The second level is the defense trade with Western Europe, which is in Europe's favor. But that reflects U.S. expenditures in Europe to support our troops stationed there. Now the third level is the one that Europeans focus on, the arms trade in equipment as a separate measure of U.S. cooperation in alliance matters. And here, past estimates of this arms trade between us and our European allies have indicated that this two-way trade is weighted 10 to 1 in favor of the United States. What this means, of course, is

that our European allies expect us to demonstrate our cooperation by buying more European defense items.

And having just come back, as you mentioned, Mr. Chairman, from a trip in Europe with the Secretary of Defense, I can tell you that we do come under heavy pressure from all of these countries that buy 2, 3, maybe up to 10 times as much in arms from us than we buy from them, and who believe, both from the point of view of their national security, as well as for economic considerations, that they are entitled to build up a healthy defenes industry of their own.

Now let me tell you in concluding this overall testimony something about the Defense Department's plans and policies on these issues of foreign sources.

We in DOD have statutory authority under the Armed Services Procurement Act to restrict the production to U.S. sources for mobilization base purposes. In almost every case of a major DOD procurement of foreign equipment, we required a U.S. source to be licensed for production. Our goal is to have a domestic production capability for all critical military items. We maintain a list of restricted items which cannot be procured from foreign sources which covers about $2 billion in acquisitions annually, a substantial sum.

We also review potential offset arrangements offered by U.S. industry to insure that there would be no adverse impact on the surge capability. For example, there is a U.S. source for every part of the F–16—we have an offset arrangement on the F–16 aircraft—there is a U.S. source for every part, despite the fact that European industries participate in a significant coproduction program on that aircraft.

Then there's our plan for the acquisition reform which was instituted by the Defense Department this spring, which includes some 32 mutually reinforcing initiatives. I have attached a full list to my statement. Let me just briefly summarize, Mr. Chairman, their principal points:

We want to insure more economic rates of production to reduce unit cost;

We want to increase program stability through full funding of R. & D. procurement at levels sufficient to accommodate design changes, testing, and supportability and readiness;

We want to establish greater stability in economy through multiyear contracts, and we appreciate the congressional support we got in making the necessary changes on this this year;

We want an evolutionary approach to weapons system development through preplanned product improvement rather than pushing of the frontiers of technology in every weapons system;

We want a simplified approval process for improvement in decisions on weapons system acquisition; that is to say, here DOD has to put its own house in order to simplify its procedures;

We try to get enhanced authorities and responsibility for program managers;

And finally, we want increased stress on competition.

In short, these intiatives are aimed at providing adequate funding at the outset, and stability throughout the weapons programs.

Now to revitalize the industrial base further, we have supported a tax bill which recognizes equipment replacement costs, and have ini-

tiated a higher threshold on progress payments. We are now experimenting with a flexible progress payments scheme which gives more help to small contractors. We are considering stepped up incentives for productivity by industrial contractors, and payment by prime contractors to vendors before primes are paid. We will reduce the regulatory burden on contractors. Finally, we will promote development of comprehensive training programs to address shortages of engineering talent.

Mr. Chairman, I cannot emphasize sufficiently how much we have to depend on the cooperation of the legislative branch on these reforms. Many require legislative action or legislative willingness to support these programs in the authorization and appropriation process. Therefore, obviously, on this issue and every other issue, we have to work together.

Finally, a word on critical materials and strategic mineral stockpiling.

Here, we are working closely with the Federal Emergency Management Agency, FEMA, and other departments to make up for potential critical materials shortages in the event of war emergency. We in the Defense Department provide advice and support to FEMA. FEMA is the agency that has the critical policy responsibility for the national defense stockpile of strategic and critical materials. Specifically, we assist in the construction of wartime planning scenarios; provide expected DOD budgets and requirements under those scenarios; we participate in the annual materials planning process to determine stockpile acquisition and disposal strategies. We work closely with FEMA in the revision of stockpile goals.

The Defense Department must tell FEMA what is to be expected of the wartime DOD budget, shipping losses, sources of supply, and processing availability, so that FEMA can determine how to shape the stockpile.

Many of the materials stockpiled currently have inventories which are in serious shortfall. In cooperation with these other agencies, we will continue to seek through the appropriations process and through moneys obtained through sales of materials in excess of their goals—primarily silver—we will seek sufficient funding to reduce these shortfalls as soon as possible.

In some cases, we will need to maintain a minimum production level capability—the production itself, not just the materials—for processing these materials. For example, the capability of processing high-carbon ferrochrome from chrome ore allows us to hold stockpiled material—in this case, chrome ore—in a form which allows the greatest flexibility to accommodate changes in production that may develop in the future.

Now the President, for this reason, has recently extended this industry's tariff protection for another year. During the next year, we will work closely with the Commerce Department, FEMA, and other agencies to investigate the health of other critical materials' processing industries.

We are giving the industrial base the increased attention in the Department, and to emphasize this point, the Defense Department has obtained the services of Sol Love, former president and chief executive officer of Vought, to create and chair an Industrial Task Force

for the Secretary of Defense. His charter is to work across functional staff lines and investigate those areas of industrial base problems where his extensive experience and unique expertise can be be utilized.

Although Mr. Love has been with us for only a few months, he has already been helpful to me and to the Secretary extensively as an adviser, and helped with several of my working groups as a troubleshooter on some particularly vexing problems of industrial production. He is also a direct channel for us to the senior echelons of the American industrial establishment.

He has, for example, investigated industrial responsiveness with a particular emphasis on surge potential, the most important capacity of our defense industry, to step up the production of arms in time of war and time of crisis.

I was interested, Mr. Chairman, to see that one of the businessmen testifying before you suggested the formation of an industrial advisory group. We have done just that. Secretary Weinberger and Ambassador Brock recently cosigned the charter for a Defense policy advisory committee on Defense trade matters. This committee will be made up of 30 chief executive officers of U.S. industry, 10 of whom will be in the supplier or vendor category. This committee will provide policy advice to Defense and the U.S. Trade Representative on trade matters and their impact on the U.S. industrial base.

Mr. Chairman, this completes my formal statement. I now stand ready to respond to your questions.

Senator JEPSEN. Thank you again, Mr. Ikle.

[The prepared statement of Mr. Ikle follows:]

Prepared Statement of Hon. Fred C. Ikle

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you to discuss the Defense Department's needs for industrial readiness. I understand that your particular concerns this morning are with the impact of foreign sourcing of U.S. defense items on our domestic subcontractor base, and the Defense Department's plans to strengthen the subcontractor base.

First, let me assure you that DoD fully appreciates the importance of a strong industrial base to our national defense. An industrial base, capable of rapid expansion to support our mobilization and sustain deployed forces is an essential component of our defense posture. There is no question that such an industrial base can add to the deterrence of war.

We have developed a DoD Action Plan for Industrial Responsiveness, with three major thrusts: national resources, the defense acquisition process, and industrial preparedness. We are seriously concerned about the defense industry--especially with respect to the fundamental strength of the base--its productivity, the quality and reliability of its products, leadtime, diminishing manufacturing sources, and its ability to respond to normal demands as well as surge and protracted emergency requirements. We believe that with prudent attention and joint commitment by both government and industry, we will succeed in revitalizing the industrial base.

When we speak of the defense industrial base, we refer to that industrial capacity in both the private and public sectors that is necessary to support the military materiel required for our national security. With the possible exception of the ammunition base, there is no separate, "captive" defense industrial base. By law,[1] and by this Administration's policy, we will rely, to the extent possible, upon the private sector of the base to support our national security needs. Although the Department of Defense has a major investment in facilities and production equipment,[2] we largely rely upon the 25 to 30 thousand prime contractors and numerous subcontractors in the commercial marketplace. We are therefore dealing in a complex, interdependent commercial marketplace.

Because the greatest share of the base is the private sector, we must look to profit and business stability as primary incentives for a viable base. Unfortunately, defense business does not always offer these incentives. The Cyclical nature of defense business and the post-Vietnam period of decreasing defense procurement have made it unattractive to many suppliers. Also, we know that there is an excessive burden of U.S. Government regulations, acting as a disincentive to many potential suppliers.

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1. Defense Industrial Resource Act of 1973

2. Approximately $16 billion invested in plant and equipment

The Foreign Sector's Role in Defense Production

A DoD review of critical items in 1977 and 1978 determined that we were totally dependent upon foreign sources for over 110 critical items -- most of which were components or parts of end items that would be produced by our domestic subcontractors. (Examples of such items are bearings from Japan for submarines, hydrauiic drive motors from Sweden for sonar systems, and electron tubes from Sweden.) This review also determined that over 50 percent of our solid state products, passive devices and tube classes required for support of our older items may in fact be foreign source dependent (Japan, Sweden, England and Hong Kong).

We have established policy that directs the Services and Defense Logistics Agency to take action when essential production capabilities are endangered by loss or impending loss of manufacturing sources or by material shortages. The emphasis of this policy is on ensuring a continued domestic supply of critical items. For example, only in exceptional cases can foreign companies be considered as viable alternatives for new sources, and they can not be considered where industrial preparedness planning is involved and a foreign source would be the sole source. An alternative action under this policy is to utilize determination and findings (D&F) per Defense Acquisition Regulation (DAR 3-216) which requires directed procurement to domestic producers in order to preserve the industrial source necessary to meet industrial preparedness requirements.

The 1980 Defense Science Board study of industrial responsiveness substantiated that there is a growing dependence on foreign sources for critical materials, parts and components. The Office of the Under Secretary for Research and Engineering will be up-dating the last review of critical items within the next 6 to 12 months.

The reasons for our growing dependence on foreign suppliers are varied. In some instances, it stems from the lack of timely responsiveness of domestic suppliers to demands of U.S. industry. For example, lead times on machine tools made in the U.S. have been excessive. Although recently reduced to an average of 8 months, machine tool leadtimes have averaged 14 months or longer, a situation which certainly has contributed to the negative trade balance on machine tools we now face. In fact, the negative balance of trade on these tools first began in 1978 and has been increasing each year so that we now estimate that 23 percent of all U.S. machine tool purchases are off-shore. A recent illustrative example is a West Coast munitions company which received estimates from U.S. tool suppliers of 18 months waiting time; they were able to acquire the same tool from Japan in one week.

There are other examples of foreign dependence which are simply due to pricing. Domestic cobalt mining ceased at the end of 1979 since world cobalt prices were not high enough to sustain domestic production. The current market price is approximately $9/lb. The two potential domestic suppliers would require a market price of approximately $20 to $25/lb over a sustained period to justify resuming operation.

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Productivity changes also are a factor. For example, domestic consumers purchase roughly 16 percent of their annual titanium sponge requirement from Japan, despite Japan's 20 percent higher price. The reason is that Japanese sponge producers use a vacuum distilling process, which so far has not yet been adopted in the U.S. The advantage of the vacuum distilled sponge is that it considerably reduces the costs of processing the sponge into ingots.

DOD must depend, in some instances, on foreign sources as a result of the lack of leverage DOD can exert on the market. For example, it has been estimated that DOD's share of the electronic component market is only six percent. The industry, therefore, responds principally to the demands of the commercial sector (94 percent) leaving DOD to seek overseas markets, mostly in the Far East, to satisfy its requirements. This particular case and others similar to it are not of immediate concern because the domestic capacity to produce these products is being protected by domestic markets, and in the event of an emergency we could direct production to meet DOD requirements, umder the authorities granted in the Defense Production Action.

Most critics argue that it has been the lack of reliable defense business that has caused subcontractors to seek business elsewhere or go out of business. Statements of businessmen before this Subcommittee on 30 September are good examples. One thesis presented in this Committee's 29 October hearings[3] was that it is the dependence of defense oriented subcontractors on

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3. Joint Economic Committee, Subcommittee on Economic Growth and Intergovernmental Policy, 29 October 1981 (Professor Lester Thurow of MIT)

defense contracts that causes them to lose their technological and market leads to foreign competitors. This is another version of the argument that the Japanese, for example, have gained a competitive edge in some world markets because of their low defense spending which does not crowd out productive investment as does U.S. defense spending. This argument was refuted in that hearing, and I believe correctly so, because there is no reason in principle why the U.S. cannot design taxes (for example) to promote the kind of investment desired to raise productivity. In any event, I understand that there is little evidence that the share of business investment spending in GNP was correlated with changes in defense share.

I should point out that we are not against foreign contracting or subcontracting per se. We are aware of our international obligations under the Government Procurement Code of the General Agreement on Trade and Tariffs (GATT), and, in particular, our arms cooperation initiatives in NATO which are reflected in the eleven reciprocal procurement agreements we have established with our allies. In this context, we view foreign competition to be healthy for the strength of the NATO Alliance. Our task in DoD is not only to fulfill our international commitments, but also to exercise sound judgment before restricting certain critical military items from being produced offshore. Our industrial preparedness program requires the Military Departments to identify possible sole source situations in the United States and dependence in foreign sources.

Another criticism of foreign sourcing arises from "offset" arrangements whereby a foreign buyer of a U.S. defense good seeks compensation for its purchase by getting a part of the production action, or by selling some of its goods to the United States. The Defense Department's policy since 1978 has been generally to oppose such arrangements on a government-to-government basis, and the outstanding balance of such offsets has declined as a result. Although we do not know its absolute size, we believe that the magnitude of commercial offset arrangements is growing. The Treasury Department, in collaboration with the Aerospace Industries Association and the Electronic Industries Association, is attempting to determine its size.

It is important to keep in mind our two-way trade balances with our NATO allies, because these balances affect their perceptions of U.S. cooperation in alliance matters, just as we expect Japanese cooperation on trade issues because of what we perceive to be an inequitable trade balance in their favor. At the aggregate trade level, the U.S. maintains a healthy trade surplus with our European allies (Table I). Although aggregate defense trade with Western Europe is in Europe's favor (Table II), that reflects U.S. expenditures in Europe to support our troops stationed there.[3a] The Europeans view the arms trade in equipment as a separate measure of U.S. cooperation in alliance matters -- past estimates of this arms trade have indicated this particular segment of the two-way trade is weighted 10 to 1 in favor of the U.S. What this means, of course, is that our European allies expect us to demonstrate our cooperation by buying more European defense items.

[3a] Including local purchases by servicemen and their dependents.

Defense Departments Plans and Policies

DoD has statutory authority under the Armed Services Procurement Act[4] (as amended) to restrict production to U.S. sources for mobilization base purposes. In almost every case of a major DoD procurement of foreign equipment, we required a U.S. source to be licensed for production. Examples are the Roland Missile, the MAG-50 machine gun, multipurpose ammunition from Norway, and the Navy's MK 75 gun mount from Italy. Our goal is to have a domestic production capability for all critical military items. We maintain a list of restricted items which cannot be procured from foreign sources which covers about $2 billion in acquisitions annually. We also review potential offset arrangements offered by U.S. industry which would entail work on major DoD production programs to ensure that there would be no adverse impact on the mobilization or surge capability of the DoD program. For example, there is a U.S. source for every part of the F-16--despite the fact that European industries participate in a significant co-production program on that aircraft.

Our plan for acquisition reform includes some 32 mutually reinforcing initiatives which I have attached to my statement. Let me briefly summarize their principal points:

-- more economic rates of production to reduce unit cost and acquisition time

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4. 10 U.S.C. 2304(a)(16)

-- increased program stability through full funding of R&D procurement at levels sufficient to accommodate design changes, testing, supportability and readiness

-- greater stability in economy through multi-year contracts

-- an evolutionary approach to weapons system development through pre-planned product improvement rather than pushing of the frontiers of technology in every weapons system

-- a simplified approval process for improvement in decisions on weapons system acquisition.

-- enhanced authorities and responsibility for program managers

-- increased stress on competition

In short, these initiatives are aimed at providing adequate funding at the outset, and stability throughout the weapons programs.

To revitalize the industrial base we have supported a tax bill which recognizes equipment replacement costs, and have initiated a higher threshold on progress payments. We are now experimenting with a flexible progress payments scheme which gives more help to small contractors. We are considering stepped-up incentives for productivity by industrial contractors, and payment by prime contractors to vendors before primes are paid. We will reduce the regulatory

burden on contractors. Finally, we will promote development of comprehensive training programs to address shortages of engineering talent and critical shortages of blue collar workers.

As you are probably aware, our review of major programs indicated that 41 percent of cost growth was due to quantity and scheduling changes. Inflation adds about 30 percent more. Our efforts in the Defense Department are focused, of course, on that 41 percent. Insofar as instability in defense business has contributed to the decline of a subcontractor base, and hence less competitive subcontracting, these efforts may also reduce some of the cost-induced inflation in the defense market.

We are working closely with the Federal Emergency Management Agency (FEMA) and other departments to compensate for potential critical materials shortages in the event of an emergency. The Defense Department provides advice and support to FEMA which has the principal policy responsibility for the National Defense Stockpile of Strategic and Critical Materials. Specifically, we assist in the construction of wartime planning scenarios; provide expected DOD budgets and requirements under those scenarios; and participate in the Annual Materials Planning process to determine stockpile acquisition and disposal strategies. We work closely with FEMA in the revision of stockpile goals to assure that they are consistent with Defense policy and requirements under the Strategic and Critical Materials Stockpile Act of 1979. The Defense Department provides such things as expected wartime DOD budgets, shipping losses, sources of supply, and processing availability, as inputs to FEMA's model. The difference between our estimated requirements (a set

of figures arrived at through analysis) and available supply in an emergency is the stockpile goal. Many of the materials currently stockpiled have inventories which are in serious shortfall. In cooperation with FEMA, General Services Administration, and other Agencies we will continue to seek through the appropriations process and through monies obtained from sales of materials in excess of their goals sufficient funding to reduce these shortfalls as soon as possible.

In some cases we will need to maintain a minimum production level capability for processing critical materials. A capability of processing high-carbon ferrochrome from chrome ore, for example, allows us to hold stockpiled material (in this case chrome ore) in the form which allows greatest flexibility to accommodate down-stream production changes. Even though the U.S. high-carbon ferrochromium industry has been decimated by lower-cost foreign competition, we felt that sustaining some minimal level of domestic production was important enough. Hence, the President recently extended* that industry's tariff protection for another year. During the next year, we will work with Commerce Department, FEMA, and other agencies to investigate the health of other critical materials industries.

We in DoD are giving the industrial base increased attention, and to emphasize the point, the Department has obtained the services of Mr. Sol Love, former President and Chief Executive Officer of Vought, to create

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*15 November 1981

and chair an Industrial Task Force for the Secretary of Defense. His charter is to work across functional staff lines and invetigate those areas of the industrial base problem where his extensive experience and unique expertise can be best utilized. Although he has been with us only a few months, he has already been used extensively as an advisor to several working groups and staffs, as a troubleshooter on some particularly vexing problems, and as a direct channel into the senior echelons of America's industrial establishment. He has investigated industrial responsiveness with a particular emphasis on surge potential and has proposed a method to establish a real surge potential as a contractual requirement. This is currently under consideration in DoD but it would be premature to discuss in detail.

I was interested to see that one of the businessmen[4] testifying before you on 30 September suggested the formation of an industrial advisory group. We have done just that--Secretary Weinberger and Ambassador Brock recently co-signed the charter for a Defense Policy Advisory Committee (DPAC) on Defense Trade Matters. This Committee will be made up of 30 Chief Executive Officers of U.S. industry--ten of whom will be in the supplier or vendor category. This Committee will provide policy advice to Defense and the U.S. Trade Representative on trade matters and their impact on the U.S. industrial base.

Mr. Chairman, this completes my formal statement. I now stand ready to respond to your questions.

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[4] Mr. John Fogarty - President of Standard Steel of Burnham, PA.

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Table 1

U.S. European Community (EC) Trade
(billions of U.S. current dollars)

Country	1978	1979	1980
Exports to EC	32.0	42.6	53.7
Imports from EC	- 29.4	-33.9	-36.3
Balance	2.6	8.7	17.4
** EC Examples **			
FRG			
Export to U.S.	10.1	11.2	11.8
Imports from U.S.	-7.0	-8.5	-11.0
Balance	3.1	2.7	0.8
UK			
Exports to U.S.	6.6	8.1	9.8
Imports from U.S.	-7.1	-10.6	-12.7
Balance	-0.5	- 2.5	- 2.9
FRANCE			
Exports to U.S.	4.1	4.9	5.3
Imports from U.S	-4.2	-5.6	-7.5
Balance	-0.1	-0.7	- 2.2
NETHERLANDS			
Exports to U.S.	1.6	1.9	1.9
Imports from U.S.	-5.7	-6.9	- 8.7
Balance	-4.1	-5.0	- 6.8

Source: U.S. Trade with the European Community, 1958-1980, Department of State I&R, 14 May 1981.

Table II

U.S. European Defense Trade
(millions of U.S. current dollars)

	FY 1978	FY 1979	FY 1980
U.S. Exports to Europe			
Foreign Military Sales (FMS)/1	985	1214	1369
Commercial Exports	583	510	679
Total/2	1568	1724	2048
U.S. Imports from Europe /1 /3	-3213	-3978	-5571
Balance	-1645	-2254	-3523

Note: 1. Imports and FMS data reflect payments made by DoD for goods and services purchased in support of U.S. forces in Europe, including logistics, maintenance support and consumption by U.S. personnel and dependents.
Source: Defense Expenditures and Related Data, OASD/ISP Nov 81.
2. Commercial exports reflect deliveries of goods and services.
Source: Foreign Military Sales and Military Assistance Facts, DSAA, Dec 80
3. Imports do not include commercial imports of defense articles.

Senator JEPSEN. I want the record to note that I know him and share with many a great respect for Mr. Ikle. He's particularly qualified to speak on the subject of industrial preparedness. He's written several articles on the importance of industrial preparedness for national security and he began to do it long before the issue became popular. It's a comfortable feeling to hear the number of steps that you've already taken in your task. I do have some specific questions and I'll share the time with Congressman Richmond. We will go back and forth here.

Just to start out, Mr. Ikle, you've spoken of the advantages that we gain from the use of offset agreements with our friends and allies. You indicated that we have our own sources for every part of the F–16.

Mr. IKLE. Right.

Senator JEPSEN. Even though we do have offsets.

Mr. IKLE. Even though we have a coproduction arrangement, Mr. Chairman, right.

Senator JEPSEN. And that kind of brings to mind this question: Does the Department of Defense, or do the services, ever direct a contractor to enter into an offset agreement with a foreign supplier or vendor in order to facilitate a U.S. foreign policy initiative? Is that dimension entered into?

Mr. IKLE. Well, there may be several motives involved.

On occasion, the willingness to consider offset arrangements may, of course, facilitate the contract with the foreign buyer to begin with. But once we have such an arrangement, even without any explicit agreement, and as I mentioned, we're staying away from government-to-government offset agreements now, you do have, Mr. Chairman, foreign policy pressures that make it very desirable for the U.S. Government to be able to point to purchases of military items, of arms, from our close allies, because in many instances, you have such a balance of arms purchases that it's so strongly in favor of the United States and the allied government has its own domestic pressures to consider—it may furnish important support to the United States in terms of bases, in terms of policies, in terms of other cooperative arrangements; that is, it's desirable to have some kind of quid pro quo. It's sort of a fact of the political life of any alliance.

Senator JEPSEN. What I'm hearing you saying is that in some situations, it may involve some additional—either just good judgment, good business, good relations—foreign policy or otherwise, reasons for maybe entering into an offset arrangement. But that would never be done at the expense of our own industrial surge capacity and preparedness.

Mr. IKLE. Precisely. We want to avoid that. But you can, in the sense that you cannot avoid it in most cases of these foreign purchases, to do it at the expense of the volume of business of our domestic defense industry. That is, of course, the painful aspect of it. But it would not be done in a situation where our surge capability would be seriously impaired.

Senator JEPSEN. You mentioned the multiyear contract, which I have had great personal interest in and have worked on, and I'm pleased to see that you've made some progress. But actually, in multiyear contracting, realistically, what good is it without the authority and, on a practical basis, the ability to enter into multiyear financing?

Or, in other words, guaranteed money. If I were an industrialist and you came out with a multiyear contract and said, "We've gotten a lot smarter and we're going to do this." Now you can go, in turn, and tell your subcontractors that we're going to plan for 3 years and that all makes sense. That's a lot better than we used to do. We used to go year by year and it's like Christmas. At the beginning of every year, you wonder what's coming up or what's going to be in the new package.

But, really, have we done enough on that multiyear contracting basis? Is there something missing by not being able to really follow through on a 3-year basis?

Mr. IKLE. Let me ask William Long, Deputy Under Secretary of Defense, Research and Engineering for Acquisition Management, who is sitting on my right, to answer this question.

Mr. LONG. Mr. Chairman, the present posture of multiyear is a giant step forward from the past. The Government really doesn't need to get involved in the financing up front. The Government does, however, through a cancellation ceiling, protect the long lead investment that the contractors make.

Now if the multiyear concept is properly applied only to programs which fit certain rather clearly defined criteria, some of which are stable costing, defined need, and several others, then the prospects of cancellation within the 3-, 4-, or 5-year period of the multiyear purchase, are extremely remote.

If, however, cancellation does occur, then the contractor at all levels, the prime and his subs, are entitled to a cancellation fee determined under a predetermined formula.

So there is financial backing in that sense, but not present cash flow financing.

Senator JEPSEN. So there's no hesitation on the part of the prime contractor to go ahead and invest multimillions of dollars, hundreds of millions of dollars in retooling and so on on a multiyear contract. What I hear you saying is there are plenty of guarantees and pop-off valves and protection for that contractor.

Mr. LONG. It remains yet to be tested on a major weapons system. As you know, heretofore, the cancellation ceiling was $5 million. It is now specifically approved with respect to the F–16, which is a multibillion-dollar program. We believe, and the contractors involved believe, there are sufficient protections to enable this program and certain others to go forward on a multiyear basis. And I'm confident that the program can be amended or modified, if necessary, if in thinking it through we've missed something. But I don't think we have.

Senator JEPSEN. Along that line, if I may, Mr. Ikle, ask another question of Mr. Long. We've been very encouraged, to say the least, by the initiatives to reform DOD acquisition, the process and so on. Could you tell me what strategies are contemplated to insure that the benefit, of these initiatives, the multiyear contracting and others, will flow down to the second- and third-tier vendors and suppliers; in other words, have you taken any specific steps or asked for any reports or anything else needed to see that the second-, third-, and maybe even fourth-layer suppliers and subcontractors receive some of the benefits?

Mr. LONG. Various of the elements of the Acquisition Improvement

Program have to be looked at differently in that regard. Starting with multiyear, that will be apparent on its face, because the dollar savings that flow from a multiyear program or contract can only reach their maximum—and we'll know this in the negotiation process—if the multiyear program itself is flowed down. The subcontractors won't make the investments unless they are getting the multiyear benefits. If the subcontractors aren't multiyearing themselves in getting the benefits, then the savings just aren't going to materialize. And in the F–16, for example, over 60 percent of the total dollar value of the contract is outside the prime contractor's plant.

So the prime contractor cannot come forward with the substantial savings that we know by analysis are there unless he flows it down.

Another way to assure flow down is through our increased progress payments procedures. We have a vehicle to assure that flow down is happening to a great extent because the prime or the higher tier contractor cannot include his subcontractors' or lower tier subcontractors' invoice in his request for progress payments unless and until he demonstrates that he has paid the next step down.

Senator JEPSEN. Is that new?

Mr. LONG. It is new as of last summer. Without going through the whole litany, I can tell you that we are paying attention to this very carefully and as those of us in the Department are trying to preach the message, if you will, that is a continuing theme. If the program is going to be successful, it has to be flowed down to the lowest level.

Senator JEPSEN. Congressman Richmond.

Representative RICHMOND. Thank you, Mr. Chairman. Mr. Ikle, in your prepared statement you say, "Also, we know that there is an excessive burden of U.S. Government regulations acting as a disincentive to many potential suppliers."

My findings are not U.S. Government regulations; my findings are that there is an excessive burden of DOD regulations. The average American manufacturer would just as soon not deal with our Defense Department.

Mr. IKLE. Congressman Richmond——

Representative RICHMOND. When I say that the average American manufacturer would just as soon not deal with the DOD, I'm correct, aren't I?

Mr. IKLE. I agree with your——

Representative RICHMOND. Now the next question I always ask is, why don't manufacturers want defense business? They say, it's just too complicated. They ask us to do things that are ridiculous. The price is three times our commercial price. Their specs are totally unnecessary. Everything is overmanufactured and overpackaged, overpreserved, overdelivered, overexamined, and overpaperworked. They say, we'd just as soon not have the bother.

Now, you and I know that's the case. I can tell you about my own companies. My own companies would just as soon not do defense work because it's just too time consuming and burdensome, too many inspectors and just too much redtape.

So it's really not the U.S. Government regulations; it's DOD's own regulations. You're not responsible for that. This has happened over the years. Is there any task force at DOD that is trying to cut out some of the unnecessary packaging and specifications and overmanu-

facturing required for DOD products so that same bearing or same forging that a company will sell to General Motors for $16 won't have to be sold to DOD for $48.

Mr. IKLE. Congressman Richmond, I agree with the general thrust of your observation. The case you mentioned, I did not mean to exclude with my observation that the U.S. Government regulations are too burdensome. I included DOD in the U.S. Government. And I know that some of our regulations are not mandated by law and therefore, to put the house in order, charity can start at home. We have to start within DOD.

We have been engaged in an effort of scrubbing down the excessive regulations. Not all of them can be removed or reduced in their burdensome impact without legislative change. Many of them can. The latter task is one that you're quite right. This is the implication of your observation. The latter task we should really get done with quickly in DOD and put our own house in order. I fully agree with you.

Let me have Mr. Long maybe here make some——

Representative RICHMOND. Mr. Long, I think that this could save untold billions and make Defense Department business much more attractive to the average American manufacturing corporation.

Mr. LONG. Congressman Richmond, the senior management in the Defense Department could not agree with you more and probably could not have said it as well as you. Specifically, in answer to your question, one of the elements of the acquisition improvement program goes directly to the simplification of the acquisition process, for its own sake and to remove the burden.

In that regard, we have two activities specifically that I'd like you to be aware of. One, which is barely underway through my office, is a review of the entire eight volumes of Defense acquisition regulations, which have built up over the years, as you know. And it's very easy for a bureaucracy to add a regulation, but it seems very difficult for a bureaucracy to remove one. A specific effort is being made to weed out the obsolete, the unnecessary.

The second activity is a pilot program that we have initiated through the Air Force contracting facilities. We have asked them to select two reasonably major large contracts, not major weapon system contracts, but high dollar volume acquisition programs, and sit down with the program manager or the contracting officer and the contractor, as you and I might as two businessmen, and negotiate a contract and see what we come up with. Then my office will give whatever waivers are necessary to approve that contract instrument without incorporating by reference all of the regulations, all of the military specifications. We would just limit it to what the two parties involved think is absolutely necessary and see what we come up with, again, to simplify the format.

Representative RICHMOND. Mr. Ikle and Mr. Long, you say that we're dependent upon bearings from Japan for our submarines, on hydraulic drive motors from Sweden for our sonar systems, and electronic tubes from Sweden. That scares me to death. What kind of country are we? Here, we're spending this incredible amount of money on defense procurement and what happens if war breaks out? What do

we do for bearings and what do we do for electronic tubes and what do we do for hydraulic drive motors?

Isn't it part of our defense strategy to make certain that we do have local manufacturers in the United States who are capable of manufacturing all of these things? I don't want to depend on Japan for anything.

Mr. IKLE. Well, as I mentioned in my testimony, for the most critical items, we do require domestic sources.

Representative RICHMOND. But what about the statement you made here about——

Mr. IKLE. We would have to look at the specifics.

Representative RICHMOND. Well, in your prepared statement you say "bearings from Japan for submarines, hydraulic drive motors from Sweden for sonar systems, and electronic tubes from Sweden."

Mr. IKLE. Well, basically, we have no disagreement with the importance of having domestic or secure supplier—maybe Canadian and U.S. suppliers or, in some cases, maybe allied suppliers considered as secure. But in most cases, we would want to have a U.S. supplier.

There's no disagreement, Congressman Richmond, with the importance of having that secure supply. That was the thrust of my whole testimony here. These illustrations are examples of where the policies either maybe have not been yet implemented with sufficient rigor, or where we can tolerate for the time being the foreign source because with some difficulty or maybe some time delay or some cost increase, we could then switch to a domestic source.

Representative RICHMOND. It would seem to me that on such important items as you list here—and I'm sure that there are many more—as a matter of national defense, we certainly ought to have at least one domestic manufacturer tooled up and capable of manufacturing these things.

Now, you take a bearing for a submarine. You and I know that bearing for a submarine is a very special bearing. And the idea that we have no manufacturer in the United States that is tooled up to manufacture that bearing is sort of frightening.

Mr. IKLE. Well, obviously, I fully agree with the principle that you——

Representative RICHMOND. And both you and I know that bearings need constant replacement, too.

Mr. IKLE. The particular case, before we highlight one as against another, one would have to know the full story, the possibility of generating within a short period alternative sources. The more time you have, Congressman Richmond, to turn things around in our domestic industry in support of defense production that may become necessary in an emergency, of course the easier the job is.

In World War II, we, of course, had a massive expansion of defense production over a short time. Two important things we must keep in mind in looking at that episode: One, the arms, by and large, were simpler, less complex items than they are today; and second, and that's most important, there were 2 or 3 years of preparing our defense industry as a result of the lend and lease and British purchases.

As we now move ahead in our expansion under the Reagan defense program of gradually increased, steadily increased defense budget, we will substantially improve the capability of our industry to respond, should the emergency arise, to the requirement for a very rapid search.

Representative RICHMOND. One last question. You say that we should promote productivity through taxes. Well, we just passed a tax bill which, theoretically, was supposed to do precisely that. We modernized the depreciation rate. We gave special waivers to certain industries. But as you know yourself, the increase in capital goods purchases, not only hasn't it increased, but it's declined—our machine tool industry really doesn't have too much leadtime right now because they don't have too many orders on their books right now.

And in spite of the great tax bonanza we just gave the American businessman and businesswoman, it hasn't showed up in improved capital expenditures and plants. Now how are we going to give tax benefits for productivity? I don't know, because productivity itself should make money. It seems to me that every manufacturer in the United States would want to improve his or her own productivity because that's how they can earn profits and make their laborers happier by giving them more money.

But I think, from something you both have said, that there is a need to change some of your procurement habits and tie them more into the domestic manufacturing setup as it is—in other words, decent production run instead of bits and pieces, decent timeframe for tooling, the various things we do in commercial industry, in order to bring costs down and production up. My understanding is that in DOD, we just don't do that.

Now I'm glad to hear that you folks are trying to institute some of those programs. I know in the aircraft industry, for example, so much money is wasted by short orders, when you know perfectly well, the following year and the following year you will have additional orders. Am I right?

Now all of that is being improved, you say?

Mr. IKLE. I hope so, Mr. Richmond. I'm pleased to hear that we seem to be pushing in the same direction. It was a rather close call to get the congressional support for multiyear contracting this summer. And, as I expressed earlier, we appreciate that we did get in the end, with a rather close vote, the congressional support for that step.

As we come forward with additional steps moving in this direction, I'm very gratified to anticipate your support for that.

Representative RICHMOND. In other words, you must have multiyear contracting.

Mr. IKLE. That was very important, right.

Representative RICHMOND. Otherwise, you can't have any kind of——

Mr. IKLE. There are additional steps and maybe Mr. Long wants to mention some specific examples which we will want to take and for which congressional support will be essential.

As to the impact of the tax bill, I believe the time has been a little bit too short yet to say what effect it will have. I'm more optimistic and I do hope that, given sufficient time, it will stimulate productivity.

Representative RICHMOND. Well, of course, it hasn't done much for the steel industry, has it? What are you folks going to do about the steel industry? The steel industry, and I know we're going to hear from Mr. Kiss on shipbuilding, these two industries in the United States that are so critically necessary for our defense establishment, are in very sad shape.

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Mr. IKLE. I have no particular recommendation on the steel industry. I don't know whether Mr. Long has any particular suggestions.

Representative RICHMOND. Thank you, Mr. Chairman.

Senator JEPSEN. I'm going to have to go for a vote here shortly, and I want to have a couple more questions, and then we will submit some more for the record, if I may, and not detain or keep you. Do you have additional questions?

Representative RICHMOND. No; thank you, Mr. Chairman.

Senator JEPSEN. Just a comment with regard to taxes, and I know that I share this with the Congressman—it is disappointing. We did make some tax cuts. Even though it is only 60 days old, and it is true, that's a pretty short time for a defense tax cut to be in place. However, I do think we had our depreciation retroactive for the whole year, didn't we?

Representative RICHMOND. Sure.

Senator JEPSEN. We all hope that industry will soon gain the confidence that we hope to instill in them to go on and invest. They are, I think, like the rest of the American people—investors and others—they're still having a kind of wait-see to see if this is for real. But I hope that they do.

A couple of things that the Congressman touched on I think are very key. The fact that the people throw up their hands and say it's just not worth it to try to do business with the Government, period. I don't want to single out the Defense Department. The 262 form is what I was advised was needed, just to get started, when I had a meeting set up with the Small Business Association people in Iowa and Dave Stockman earlier this year.

But backing into another thing that the Congressman touched on, and that is that the overprograming and the overpackaging—and I say this constructively—the officiousness, the we-know-best-how-to-do-things attitude and, in addition to that, we've got an awful lot of people that we've got to justify existence for—now this is the way that the bureaucracy comes off in the private sector, so, therefore, we're going to tell you. And we have testimony on this from Delvin Corp. in Iowa. They make fuel injectors for jet engines. They make them and the end result is exactly spec-wise, exactly performance-wise, absolutely result-wise what is ordered for jet fuel injectors.

But when they went to work on a Government order, by the time the Government came in, they had to remake the mousetrap all over again. They had to do it with their specs. And the same exact fuel injectors that they were selling, meeting all the tests for $50, ended up costing the Government $200. The time involved, the retooling involved, this type of thing—I know, from knowing you, Mr. Ikle, that that type of nonsense, and I can't think of any different name to call it, just has to stop, absolutely. That's just unacceptable.

Another thing that was touched on is that we're currently dependent on overseas sources for many classes of large forgings and that we trail the Soviet Union in the capacity and the technology to make, for example, titanium-hulled submarines similar to the aquaflats. The Congressman was touching on the fact that some bearings that are very necessary aren't even made in this country. And that's not the only thing.

How do you assess this situation? What corrective measures are necessary, Mr. Ikle, to remedy this?

Mr. IKLE. Mr. Chairman, we have a study underway now, a detailed study of the need of the use of some 200,000-ton close-die forging capability. This analysis should be completed in the next 6 to 12 months and should give us a better understanding what we should change.

Prior to having that analysis completed, Mr. Love, whose name I mentioned, did a preliminary investigation for me and concluded, if I remember this exactly right, that the problem of the forging industry was far less serious than was reported in many of the anecdotal accounts.

In essence, the short answer to your question is, we try to come to grips with the problem and define it clearly and see what must be done about it.

Senator JEPSEN. I think that maybe this is one area where Government involvement is proper. In other words, the things that we can't do so well at all for ourselves, in keeping with the philosophy of some of us who are called conservative, are appropriate areas for Government involvement. And certainly, you know, a number of the industry representatives at the September hearing talked about the many foreign industries receiving lavish assistance from their governments in the form of subsidies, accelerated depreciation, loan guarantees, and so on. Where we have a need for the rare bearings or the titanium-hulled submarines, or something similar—I don't mean that specifically, but the things that we don't have but really need for national security—I certainly would be willing to entertain Government support of this and would urge my colleagues at least to seriously consider it also.

Is this being looked at or considered to make sure that we have access to all of the things we really need so we don't have what is known, at least in some circles, as the denial of control of trade routes, and the problems that happen when that type of thing takes place?

Mr. IKLE. Certainly, we do not preclude selected and occasional use of Government support, Government getting into the industrial production of certain items. I mentioned in my testimony the example of extending the tariff protection for chrome processing.

So, certainly, this administration does not exclude that approach when it can be helpful and necessary.

Senator JEPSEN. Do you have any additional questions?

Representative RICHMOND. No.

Senator JEPSEN. Let the record show that we will keep this hearing open for the purpose of submitting additional written questions from any other member of the subcommittee until the close of business tomorrow. I think it's such an important area that I want to make sure that our colleagues have an opportunity to do so. And we will also submit some additional written questions in writing for reply. And, again, I want to express my appreciation and thanks to you, Mr. Ikle, for all that you're doing, for the efforts that you've put to come here today. I look forward to working with you and I think I speak for every member of this subcommittee that we are glad you're here in Washington in your capacity.

Mr. IKLE. Thank you, Mr. Chairman.

Senator JEPSEN. Thank you. I will now ask Congressman Richmond to take over the chair for just a few minutes. I am going to vote and will be right back.

Thank you, Mr. Ikle. Next we will hear from Ronald K. Kiss.

Representative RICHMOND [presiding]. Mr. Kiss, I am glad to see you. Would you prefer to have your entire prepared statement printed in the record as presented and have us have a discussion, or——

TESTIMONY OF RONALD K. KISS, ACTING ASSOCIATE ADMINISTRATOR FOR SHIPBUILDING AND SHIP OPERATIONS, MARITIME ADMINISTRATION, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY EDWARD S. KARLSON, CHIEF, DIVISION OF PRODUCTION, OFFICE OF SHIP CONSTRUCTION

Mr. KISS. That would be fine, sir.

Representative RICHMOND. Without objection, Mr. Kiss' prepared statement will be printed in the hearing record at this point and we will begin questioning immediately.

[The prepared statement of Mr. Kiss follows:]

Prepared Statement of Ronald K. Kiss

Mr. Chairman and Members of the Subcommittee:

My name is Ronald K. Kiss. I am the Acting Associate Administrator for Shipbuilding and Ship Operations of the Maritime Administration (MarAd), Department of Transportation. I am pleased to address this Subcommittee on behalf of Admiral Harold E. Shear, Maritime Administrator, with respect to the Maritime Administration's concern with the defense industrial base.

It is our understanding that the Subcommittee's primary interest in the maritime area concerns the use of foreign sources for ship construction materials and components. Before addressing United States shipbuilding at that level of detail, I will give a brief overview of the maritime industry, especially the shipbuilding segment, and how the primary MarAd financial aid programs have operated in the past. These programs and policies are being carefully reviewed in the development of an overall maritime policy.

The Maritime Administration administers a number of programs to promote the American Merchant Marine, including shipping companies, shipbuilders, and ports.

Foremost among the statutes fundamental to our activities is the Merchant Marine Act of 1936, as amended. The declaration of policy of the Act states that:

> "It is necessary for the national defense and development of its foreign and domestic commerce that the United States shall have a merchant marine (a) sufficient to carry its domestic water-borne commerce and a substantial portion of the water-borne export and import foreign commerce of the United States and to provide shipping service essential for maintaining the flow of such domestic and foreign water-borne commerce at all times, (b) capable of serving as a naval and military auxiliary in time of war or national emergency, (c) owned and operated under the United States flag by citizens of the United States insofar as may be practicable, (d) composed of the best-equipped, safest, and most suitable types of vessels, constructed in the United States and manned with a trained and efficient citizen personnel, and (e) supplemented by efficient facilities for shipbuilding and ship repair."

Of primary importance to shipbuilding under this Act are the Construction-Differential Subsidy (CDS) program, the Federal Ship Financing Guarantee (Title XI) program, and the Capital Construction Fund (CCF) program. The CDS program provides for payment of construction subsidies directly to U.S. shipbuilders equal to the difference in price between constructing a vessel in a foreign shipyard versus having the same ship constructed in a U.S. shipyard, but not to exceed 50 percent of the cost of the vessel. The Title XI program provides long-term debt

financing guarantees at favorable credit rates for the construction or reconstruction of U.S.-flag vessels in U.S. shipyards. The CCF program provides for the deferment of Federal income taxes on funds set aside to construct vessels and certain related equipment in U.S. shipyards and factories.

The U.S. shipbuilding industry to which the above programs directly or indirectly provide benefits comprise about 180 shipyards of varying sizes. These shipyards are available for mobilization purposes in times of national emergency. Of special importance in planning for mobilization are the number of shipyards and building positions capable of constructing vessels of 475 feet in length and larger which can be used to carry supplies, ammunition, and petroleum products in the event of national emergency.

The shipyard capacity required for mobilization work, which include battle damage repair, normal repair, activation of reserve fleet vessels, and wartime construction is 83 building ways and 139 large drydocks, supported by a production work force of 136,000 employees. This capacity is represented by 54 shipyards amd ship repair facilities employing a total work force (production plus overhead) of about 210,000 employees. These 54 shipyards, which include the eight naval shipyards, are termed the "Shipyard Mobilization Base."

Within the "Shipyard Mobilization Base" are 26 commercial shipyards referred to as the "Active Shipbuilding Base." The "Active Shipbuilding Base" has been defined by MarAd as those major shipyards engaged in, or seeking contracts for, the construction of naval ships and/or major oceangoing or Great Lakes merchant ships. The 26 shipyards in the "Active Shipbuilding Base" now employ approximately 74,000 production workers. Seven of these 26 shipyards are currently benefitting directly from the construction-differential subsidy programs and in addition to these seven, eight are benefitting from the Title XI program.

The foregoing data was largely derived from MarAd's annual survey of existing privately owned shipyards capable of merchant vessel construction. This survey, performed pursuant to Section 502(f) of the Merchant Marine Act of 1936 is intended to provide current data on the shipbuilding industry for purposes of national defense and national emergency planning.

The beneficiaries of our financial assistance programs also include a substantial number of smaller shipyards. For example, as of June 30, 1981, there are Title XI vessels on order or under construction in a total of 71 U.S. shipyards including the 15 shipyards in the "Active Shipbuilding Base" previously mentioned. These yards are located on all three coasts, the Great Lakes, and our inland waterways.

The U.S. shipbuilding industry is continuing to experience a generally declining orderbook and faces uncertain future prospects. Only four deep-draft merchant vessels were ordered during 1980. In the first 11 months of 1981, six merchant ships have been ordered. As of June 30, 1981, 41 deep-draft commercial vessels (the lowest number in 25 years) remained on the order-books, compared with 61 a year earlier. Twenty-nine of these 41 vessels are scheduled for delivery by the end of 1982.

There were two major bright spots for U.S. shipbuilders to help offset the decline in commercial vessel construction. As of mid-1981, a record number of 84 offshore drilling rigs were on order in 13 shipyards, and 101 Navy and Coast Guard vessels, 1,000 displacement tons or over, were under construction in 11 shipyards. Additionally, the market for offshore petroleum service vessels, inland barges, and towboats has been strong throughout

1981 and is expected to remain steady with the possibility of improvement in the coming years. Finally, repair of both commercial and naval vessels remains generally strong and indicates signs of increasing.

Considerable repair work is performed in the United States on foreign-flag ships. However, in contrast to most foreign flag vessels, which commonly have maintenance and repair services performed without penalty from their country of registry in the shipyards of other countries, the United States has maintained a 50 percent ad valorem tax on ship repairs to U.S. flag vessels accomplished abroad. This requirement is being reviewed as part of a study on the operating differential subsidy (ODS) program.

The Merchant Marine Act was amended as part of the Reconciliation Act to allow, in specified circumstances, the acquisition of foreign vessels by U.S. carriers receiving or applying for ODS. In particular the new Section 615 of the Act generally provides temporary authority through fiscal year 1983 to allow operating-differential subsidy to be paid to operators of foreign constructed, converted, or acquired U.S.-flag ships when CDS funds are unavailable. This permits ship construction in foreign yards, whereas previously, all ODS ships had to be U.S. built.

All other ship construction, including Navy shipbuilding, merchant ship construction for the U.S. domestic trade, shipyard heavy machinery fabrication, drill rigs, and ship repair activity remain unaffected by this legislation.

Other than the foregoing exception with respect to ODS, U.S. ship construction is a statutory precondition for receipt of governmental financial assistance through the CDS, ODS, and CCF programs and a precondition as a matter of policy for the Title XI programs. These programs set stringent limits on the use of foreign components. Furthermore, the Jones Act requires that ships used in the protected domestic trade be built in the U.S. Cargo preference requirements, as set forth in the Merchant Marine Act, require that eligibility for carrying government impelled P.L.-664 cargo be limited to ships built in the United States or to foreign built ships only after they have been registered under U.S.-flag for 3 years.

At this point I would like to shift the focus from the shipyards to the industrial supply base. Again let me emphasize that this is historically how the programs have operated, and that all these requirements are being reviewed in the maritime policy study. Although they are primarily directed at the shipbuilder and shipowner, MarAd programs, through their various restrictions on the use of foreign materials and components, also provide extensive protection to the shipbuilding industrial base. In addition, MarAd, in cooperation with the Department of Defense, participates in the Industrial Preparedness Planning (IPP) program which has the objective of ensuring that the national industrial base will be capable of producing adequate and timely deliveries of marine-related materials and equipment under mobilization conditions. Through this program we are alerted to decreases in the ability of the industrial base to meet anticipated logistics requirements.

In addition, we also participate in interagency groups such as the Department of Commerce's Industry Evaluation Board (IEB) that analyze industrial base issues, all with the objective of maintaining awareness of the capacity and capability of the supporting industrial base.

The administration of the "Buy American" requirements of the Merchant Marine Act also serves to alert MarAd to prospective problems in the supply industries. Section 505 of the Merchant Marine Act of 1936, as amended, states with respect to CDS grants:

> "In all such construction the shipbuilders, subcontractors, materialmen, or suppliers shall use, so far as practicable, only articles, materials, and supplies of the growth, production, or manufacture of the United States as defined in paragraph K of Section 401 of the Tariff Act of 1930; Provided, however, that with respect to other than major components of the hull, superstructure, and any material used in the construction thereof, (1) if the Secretary of Transportation determines that the requirements of this sentence will unreasonably delay completion of any vessel beyond its contract delivery date, and (2) if such determination includes or is accompanied by a concise explanation of the basis therefore, then the Secretary of Transportation may waive such requirements to the extent necessary to prevent such delay."

"Buy American," historically has been interpreted by MarAd to imply 100 percent American content for components. A component that has less than 100 percent American content has been considered to be of foreign manufacture.

Basically, there are only two situations where foreign procurement is permitted for CDS vessels. The first situation involves the "so far as practicable" language, under which a foreign source of supply is permitted when a component required for

normal ship outfitting is not available from a domestic source of manufacture. At the present time, only small foreign items such as manual typewriters, televisions, and binoculars have been consistently allowed in subsidized ship construction by the Maritime Administration. If the time came when foreign sources of supply were no longer available, it would be necessary to depend on the flexibility of the private-sector to respond to domestic needs.

The "so far as practicable" provision has also led to one special case in which partial foreign content has been permitted for CDS construction in a component. This special case is the slow speed main propulsion diesel. Prior to the rapid increase in bunker fuel prices in the early 1970's, main propulsion engines in large oceangoing vessels of the American merchant marine had traditionally been of the steam turbine type. Steam plant and turbine design and manufacture in the United States were at a very high level of technology development. Most of the other maritime nations of the world, however, were utilizing more fuel efficient slow speed diesel propulsion for which technology was rapidly improving as higher vessel powering requirements emerged.

In 1978 MarAd determined that the high cost of bunker fuel mandated an initiative to promote the development of a slow speed diesel manufacturing capability for vessel main propulsion in the Untied States. Development of such a domestic manufacturing capability could not realistically be accomplished without a transition period. New regulations were promulgated initially permitting some foreign content in slow speed main propulsion diesels for CDS vessels, provided that the engines are assembled in the United States and that the engine supplier submit to the Maritime Administration an acceptable manufacturing plan under which future engines for CDS vessels would ultimately be of 100 percent U.S. manufacture. We received and approved the manufacturing plans of three firms. Slow speed main propulsion diesels from one of these firms are currently being installed in three large CDS containerships under construction by Avondale Shipyards, Incorporated, for American President Lines Ltd.

The second situation for which foreign procurement may be permitted for CDS vessels involves avoidance of unreasonable delay in a vessel contract delivery date. "Buy American" waivers of this type, however, are so rare as to have no impact on this nation's industrial base.

The Maritime Administration's Title XI program does not statutorily require "Buy American" for shipbuilding materials and components as a precondition for receipt of Government financing guarantees. We have in the past as a matter of policy, however, extended in principle the precepts of the CDS "Buy American" requirements to Title XI vessel construction in that, unless we grant a waiver, the costs of any foreign materials and components are excluded from the actual cost of the vessel for which MarAd will provide a financing guarantee. This policy is also under review.

At the present time, the United States is not solely dependent on foreign sources for any essential component or production category. As noted previously, diesel engines with some foreign content have been used in U.S. constructed vessels. There is not at present a capability to forge large slow-speed diesel crankshafts in this country, although the necessary equipment is available. In an emergency, however, domestically produced steam turbines could be used in lieu of the slow speed diesels, as could medium speed diesel engines or gas turbines.

The Maritime Administration has assessed our shipbuilding industry's ability to respond to an accelerated construction program in the event of a national emergency. Our national war shipbuilding program plans provide for initial construction of product tankers and combination roll-on/roll-off container-breakbulk ships. Given the existence of plans and specifications for these ships, 3 to 7 months would be required to obtain materials and components to start fabrication of new merchant vessels. At present, the initial lead-time to delivery of new vessels in a protracted conflict is estimated at 18 to 24 months. If large-scale production continued, shorter lead-times could be achieved.

At the outset of a national emergency it is likely that the schedule controlling items would be propulsion machinery and heavy castings and forgings, regardless of what types of vessels were built. The nature of the shortfalls for propulsion machinery would depend on the type of machinery installed and on competing demands for Navy construction. Within the next few years slow speed diesel plants would be in short supply under current circumstances, as U.S. production capacity has not been fully developed. If steam turbine plants were used, turbines and reduction gears would be controlling in the early stages.

Mr. Chairman, this concludes my prepared testimony. I will be pleased to answer any questions that you or the Members of the Subcommittee may have.

Thank you.

Representative RICHMOND. Mr. Kiss, I'm extremely worried by what's happening in the shipbuilding industry in the United States, where, apparently, we're month by month losing our capability of building ships.

Mr. KISS. Yes.

Representative RICHMOND. On the east coast, I hear virtually every month of a firm going out of business. Now, Bethlehem Steel of East Boston is closed down. Todd Shipyards in Redhook has closed down. Right along the east coast we hear or more and more shipyards having to close down through lack of business.

Now do we have any policy for keeping some of these operations open just as a matter of defense preparedness? As you probably know, I have a major navy yard in my own district, the Brooklyn Navy Yard, where we built the battleship, *Iowa*.

Mr. KISS. Yes, sir.

Representative RICHMOND. At one time, it employed 35,000 people. We have Coastal Drydock that operates it now repairing and refitting Navy ships. The business is up and down, up and down. Management has terrible trouble keeping experienced people on the payroll because the plant runs for a year and then has to stop because of lack of ships. They were up to 2,700 people last year; now they're down to 400 this year. You can't run a business that way.

Does our Government have any policy for keeping some of these shipbuilders in business and supporting them one way or another, as a matter of national defense?

Mr. KISS. As you know, the shipbuilding industry has been a cyclical industry ever since the close of World War II. We have no interim policy right now to try and do anything to preserve those shipyards which, of economic necessity, as you mentioned, are having to close their doors.

Representative RICHMOND. Well, the economic necessity is because the Navy just isn't pushing its ships in for rehabilitation quick enough. And, of course, they have no commercial business. But as a matter of defense policy, doesn't this country need a group of viable shipyards??

Mr. KISS. I would say, yes, absolutely. And as you know, the administration is working on the preparation of a new maritime policy which would address the entire picture, with particular focus on the commercial shipping and shipbuilding sector. There is a Navy program in the offing, of which I am not privy to all the details, which is intended to also result in a rebuilding of the fleet, at least as published in the press, from 450 ships to 600 ships.

The problem, in the short range, is how long will it take to implement these programs? And I can't answer that right now.

Representative RICHMOND. What kind of plans does the Maritime Administration have for getting the shipbuilding industry back functioning?

Mr. KISS. We're looking at the shipbuilding industry as well as all of our presently existing programs. We still have in place a limited title XI ship financing guarantee program, which should continue to impel a certain number of orders to U.S. shipyards for domestic ship construction.

The maritime programs have traditionally been reliant on the private sector for the initiative, as you're aware. It's too early to tell how

quickly things are going to happen with the programs that we still have viable at this point in time.

Representative RICHMOND. Is there any private shipbuilding business available nowadays?

Mr. KISS. Any private business available? There have only been orders for six ships this year to date.

Representative RICHMOND. In the whole United States?

Mr. KISS. In the whole United States.

Representative RICHMOND. Six commercial ships?

Mr. KISS. Six commercial ships.

Representative RICHMOND. What are they, tankers?

Mr. KISS. Well, some tankers, some ships on the Great Lakes.

Representative RICHMOND. Six in the United States, as against how many orders do you think they probably had in Germany and how many in Japan?

Mr. KISS. I really couldn't even hazard a guess, but the shipbuilding market worldwide has been depressed for about the last 6 or 7 years.

Now the Japanese business has come back. They have a substantial share of that world market, probably on the order of 60 percent.

Representative RICHMOND. So how many ships would they have, would you say?

Mr. KISS. I would have to submit the answer for the record.

Representative RICHMOND. Would you estimate?

Mr. KISS. If we have six, I would say it would be in the hundreds.

Representative RICHMOND. So we have six and they have in the hundreds.

Mr. KISS. I would guess.

Representative RICHMOND. And an awful lot of those ships are being ordered by American transport companies, aren't they? Esso, Mobil, all the rest.

Mr. KISS. Yes, that's correct.

Representative RICHMOND. Is there no way that, somehow or other, we can get that business back for the United States, mainly to put people back to work, but even more important, as a matter of defense capability. I just wonder what happens to this country if we ever go to war.

You had Mr. Ikle here a minute ago. He admits that there are God knows how many different items that we can't seem to produce in the United States. Ships are something that has been bothering me terribly. We're gradually losing the technical ability to build these things, as more and more shipyards shut down.

Mr. KISS. That's a fact. I would say as the yards close down, people turn to other businesses and other industries.

Representative RICHMOND. Sure. Now the Japanese have several hundred orders.

Mr. KISS. Yes.

Representative RICHMOND. What's the differential in price between a Japanese shipyard and an American shipyard?

Mr. KISS. It would depend on the type of a ship that we're talking about.

Representative RICHMOND. Well, let's talk about, nowadays, most ships are either container ships or——

Mr. KISS. Container ships would probably be on the order of 50 percent differential.

Representative RICHMOND. Fifty percent.

Mr. KISS. Right.

Representative RICHMOND. And it's not because of labor.

Mr. KISS. It's partly because of labor. It's partly because of the cost of the materials that are used on the ship.

Representative RICHMOND. The steel.

Mr. KISS. Steel, and other components. It's very difficult to identify precisely what the reasons would be. Most of the Japanese shipyards have their own sources of supply for main engines, for example. We hear much about dumping on the market. You can't tell whether or not an engine is dumped when it's constructed within the shipyard. They're also selling engines for export or for use by other users.

Representative RICHMOND. So you start off with, I guess the biggest item on a ship is steel.

Mr. KISS. Yes.

Representative RICHMOND. You start off with the Japanese having the great superiority over our steelmaking ability.

Mr. KISS. They have a supply system tied in with their shipyards that I visited, where they generally keep an inventory of less than 1 week's worth of steel in the yard because the supplies are practically coming in so that they can go right into the panel line and be fabricated. That does not exist in this country.

Represeentative RICHMOND. As against the inventories down at Avondale that would be, what?

Mr. KISS. Several months.

Representative RICHMOND. Several months. They get along on less capital.

Mr. KISS. That would lead in that direction.

Representative RICHMOND. And of course, we know that they've got 12 brandnew, modern steel mills and there is only, I think, 1 modern steel mill in the whole United States.

Mr. KISS. I'm not familiar with all of our steel capacity, but I trust what you say.

Representative RICHMOND. I'm told that we only have one up in Harvey, Ill. And as I said before, here you have United States Steel—it's got the money to build a new mill, but instead, they're going to take over an oil company, even though Congress passed specific enabling legislation, waiving who knows how many ecological safeguards, just so they could build a new steel mill.

But don't you think that all of this has something to do with our defense preparedness and the very guts of the U.S. Government?

Mr. KISS. I think there's no question that the viability of our shipbuilding industry does have something to do with defense preparedness, and always has, and I can't see that that will change in the future.

Representative RICHMOND. I'm sure that we weren't in such bad shape before World War II as we are now.

Mr. KISS. Probably because of the buildup which began in 1936, as Mr. Ikle mentioned, and some of the lend-lease programs, we probably were not. We were already off and running with a building program.

Representative RICHMOND. I think we had a relatively modern steel industry then. We had a fairly active shipbuilding industry.

I just wonder what happens if World War III breaks out.

Mr. KISS. Depending upon the scenario of the war, different things could happen. We have done some studies that have looked at our shipbuilding mobilization base and we have identified the status to be capable of responding to a surge at present, but it would be precarious. There would be certain components that could result in bottlenecks, such as main propulsion gears, main engines, things of this sort.

Also, the ability to respond would be dependent on the availability of plans and specifications for the ship types that would be needed. We're probably going to need medium-size tankers and multipurpose-type ships, ships capable of handling roll-on, roll-off, and lift-on, lift-off cargoes.

There are some designs of this type which have been constructed in the United States that would at least give us a starting point.

Representative RICHMOND. In aircraft, we immediately convert our commercial aircraft fleet. I think we're covered defensivewise on transportation via air, because we have, by far, the largest air fleet in the world.

Mr. KISS. Yes.

Representative RICHMOND. But, what bothers me is on sea, where we have one of the smallest navies and one of the smallest commercial merchant marines in the world right now, right?

Mr. KISS. I think our Navy is still on par with——

Representative RICHMOND. Would you say it's on par with the Soviet Union?

Mr. KISS. My information would be that it is. The merchant marine definitely is much smaller than many of the other countries.

Representative RICHMOND. Even though we know for a fact that most of those ships are controlled by American business people.

Mr. KISS. A good number of them are, and this is an area really outside of my area of expertise. But there is an argument made that those ships could be available to the United States in time of national emergency.

I think that if we're looking at the availability of shipping resources, our pecking order would be to call on the ships in our active fleet first, and then rely on ships in our Ready Reserve fleet. This is a group of ships that we have in reserve status at various national defense reserve fleets around the country on 5 to 10 days' notice.

Then we have a number of ships in the national defense reserve fleet which are generally planned to be available on a 30- to 60-day notice. These are old ships. They're Victory ships. But they have rather limited amounts of operational time.

Representative RICHMOND. Where are they now?

Mr. KISS. We have three fleets. They're located at the James River, Fort Eustis, Va., in Beaumont, Tex., and Suisun Bay in California.

Representative RICHMOND. You're talking about ships how old?

Mr. KISS. Those ships, the Victories, would be on the order of from 35 to 36 years old. But they would generally have been operated for less than 5 or 7 years over those 35 years.

Representative RICHMOND. Yes; but they're in mothballs now.

Mr. KISS. They're in mothballs, that's correct.

Representative RICHMOND. Not only do they have to be demothballed; they have to have total new electronic equipment put on them.

Mr. KISS. That may not be the case. In fact, we activated a victory ship in the Ready Reserve activation last summer. It was the first ship of the three that we activated that was on berth and ready for service. Very little had to be done to her. A few safety valves had to be replaced, and that essentially was the extent of the problem.

Representative RICHMOND. You mean it didn't require modern radar and modern sonar and a heck of a lot of modern communications?

Mr. KISS. It didn't require that. That would be desirable over the long term. Modern communications equipment, for example, would be something that it does not have. But it could go to sea and perform a resupply function as it was configured. It would be desirable to add some of these other features, but they would not be necessary.

Representative RICHMOND. How fast do they go?

Mr. KISS. Those are 16-knot ships. So they're not the speed that you would like to have.

Representative RICHMOND. And if we were building transport ships today, how fast would they go?

Mr. KISS. The Navy generally requires a 20-knot speed for a cargo ship. Most of the commercial ships in the past 10 years have been in excess of 20 knots. The high cost of fuel has been driving that speed downward, again. But still, 20 to 18 is a reasonable speed.

Representative RICHMOND. You know, Mr. Kiss, I think we're in such disastrous shape, and the American public doesn't know a thing about it. It's something like our relations with Japan that I keep trying to get the word out on. The press doesn't print a word. Here, too, the American people don't realize the facts that we no longer have virtually the capability to build a navy, a maritime fleet.

How small is our maritime fleet? We're number what in the world now?

Mr. KISS. I believe we are No. 8 in terms of deadweight tonnage. We have about 577 privately owned ships in the U.S.-flag oceangoing fleet.

Representative RICHMOND. Can you imagine the world's greatest country being No. 12 in maritime, or 13?

Mr. KISS. I think I agree with you—it's appalling. There's no question about it.

Representative RICHMOND. It would seem to me that it would be just as important to invest money in modern shipbuilding, in modern steelmaking, as in the MX missile, because we already have thousands of intercontinental ballistic missiles, but we don't have any ships. We don't have modern steel mills. We don't have modern shipbuilding companies.

You know, you think defense preparedness would go forward all in one surge. What good is an MX missile when you have no backup material at all in case of war? The only time you would use an MX missile is if World War III broke out—right?

Mr. KISS. I believe so.

Representative RICHMOND. We have nothing for transportation. We have no modern steel building capability. We heard from Mr. Ikle that we have to import an awful lot of electronic gear.

It would seem to me that it would pay the Department of Defense and the Maritime Commission to think of these things as part of our defense activities. Sure, we're going to spend how many billions of

dollars on the B–1 bomber, which Congress votes one year and then cancels the next year, year after year after year. Just think what those dollars could do to get us ready in the industrial field.

Mr. KISS. I'm certainly aware that the Department of Defense is looking at the problem that you're speaking to right now, as well as the whole industrial base question. We have had the opportunity to brief Sol Love, mentioned by Mr. Ikle, as looking at this industrial preparedness question with regard to a mobilization ship design that we have developed at the Maritime Administration. He's aware of the capabilities of the ship and the need for it, and it's part of the ongoing study that he is undertaking regarding the entire subject of industrial preparedness.

So the shipbuilding sector is one that I know is being addressed.

Representative RICHMOND. Mr. Kiss, I just got a message that my amendments are ready on the floor. We're doing a foreign aid bill over at the House.

Mr. KISS. Yes, sir.

Representative RICHMOND. I'm awfully glad to have talked with you. It just seems to me that people like you and Mr. Ikle and other bright people ought to really realize that we're in desperate shape in the United States and that B–1 bombers and MX missiles are not what we need. What we need are some trained personnel and some decent defense manufacturing capabilities. We need some basics.

In other words, what we're doing is putting on the top of the cake, but the cake doesn't exist. No matter what we do with B–1 bombers and M–1 tanks, which will never, never see the light of day, MX missiles—no matter what we do with all of this esoteric stuff, which may or may not ever come to fruition, we have basic, terrible, serious problems in the United States which nobody seems to want to address.

We have a demoralized army. We obviously need to spend money for middle management to keep them in. And certainly, if we had the money, we could also spend some of those funds for the people who really need it—the technicians. No one's doing it. We've got to reeducate members of the military services. We've got to improve their morale. We've got to improve their living standards so that they're willing to stay in the service. This is a free country. When they come to their last year of enlistment, they say, why bother? They'd just as soon go out and work for some company or industry that will utilize their technical skills and reimburse them accordingly.

And you can't build up an armed service on people who are untrained. Things might get so bad that we might even have to reconsider instituting the draft. And then we've got to get into American industry and take some of these basic critical defense type industries and, somehow or other, force them to modernize. The fact that we have to buy our bearings from Japan and our electronics from Sweden—it's embarrassing. And those are only two items. You can imagine how many other items there really must be.

Mr. KISS. The situation on the supply for the commercial ships, which are not so highly technological, is not quite so bad. We do have a number of what I would classify as minor items that have to come from foreign sources. But in terms of essential components, at

this point in time, we're not really relying on a foreign source for anything that would be essential.

Representative RICHMOND. If you'll excuse me, Mr. Kiss, I'll miss my amendment on the floor. I think Senator Jepsen will be right back. Thank you.

Mr. KISS. Fine.

[A brief recess was taken.]

Senator JEPSEN [presiding]. This hearing will again come to order.

Mr. Kiss, the one vote turned into three back to back and that's why on the final one, the third, I was delayed. The closing hours of a session are kind of a wild time for hearings. Please know that it's not because there is not the concern and interest. In fact, one of the most important hearings I think we've held is this one. I understand that we have your prepared statement in the record as if read and we've been discussing some things.

I do have some things that I'd like to get in the record and have you respond to.

Mr. KISS. That would be fine.

Senator JEPSEN. You stated that the industrial preparedness program, of which the Maritime Administration is the only nondefense member, is a very important source of information on domestic industrial capacity. How great are the resources devoted to this program by the Maritime Administration, No. 1, and No. 2, are the current plans for increasing the resources available to the industrial preparedness program?

Mr. KISS. At the present time, sir, we have essentially one full-time person devoted to working on the industrial preparedness planning program, in conjunction with the main effort in the Department of Defense. That individual, though, receives support as needed from many areas throughout the agency.

Ed Karlson, sitting to my right, is chief of our Division of Production in the Office of Ship Construction. He has an office of 23 people, including construction representatives in the field. As needed, in different aspects of industrial preparedness planning, these people all can play a role or play a part.

There are no plans, to my knowledge, at the present time to increase the personnel assigned to that area.

Senator JEPSEN. The IPP, or the industrial preparedness program, as I understand it, is administered by the Department of Defense. It's designed to provide a data base on production capacity that could be used in the event of mobilization.

The program has been criticized, especially by GAO, for its ineffectiveness in providing useful information on the industrial base. What is your comment on that? Would you comment on that statement?

Mr. KISS. Well, in terms of our planning efforts, the program has been useful. It has provided information to us when it has been needed.

As I mentioned, it's one of a number of areas that we can use to try and maintain some kind of track on what's happening in the supply industry. Often, the one that brings the shortages home most quickly is our own subsidy program, which has a buy-American requirement in it. When a shipyard is unable to comply with that, they must request either an exception or a waiver. I would say that's the more

normal way that we become aware immediately of some kind of a problem.

Senator JEPSEN. OK. Now do you find that since the industry participation in this program is on a strictly voluntary basis, do you find the participation there that you would like to see? Is it lacking?

Mr. KISS. I really don't know the answer to that question. I could submit it for the record, if you would allow me to do that.

Senator JEPSEN. All right.

[The following information was subsequently supplied for the record:]

Our experience with the industrial firms which participate in the Maritime Administration's IPP has been excellent. In fact, we have had several instances where firms have taken the initiative to enter and participate in the program.

Senator JEPSEN. Well, let's go on to another board. The Industrial Evaluation Board is listed by you as a very important source of information on basic industrial capacity. Yet, that board has come under fire recently for the poor quality of its data on the foundry industry, especially much of the information that's maintained by that board is outdated and useless.

How current are the reports issued by that board?

Mr. KISS. In terms of our involvement with that board, it has been ad hoc for many years, sir. I would say that it's not very current.

Senator JEPSEN. Not very current.

Mr. KISS. No, sir.

Senator JEPSEN. Can you provide information for the record on the average age of the reports that you have from it?

Mr. KISS. I will do that, if I can.

Senator JEPSEN. Would you please?

[The following information was subsequently supplied for the record:]

It is my understanding that a substantial number of IEB summary analyses need updating with some of them going back 30 years. An average age for all such analyses cannot be provided since only a limited number of them apply in our area of interest. Note, however, that we have developed, either at the request of the IEB or on our own initiative, several IEB summary analyses for critical marine related industrial sectors over the past 3 years. Examples include stud link anchor chain, fixed pitch propellers, and steam main propulsion units.

It is also understood that the Emergency Mobilization Preparedness Board recently established by President Reagan plans to revitalize the IEB over the next 3 years. Hopefully, program effectiveness will be improved.

Senator JEPSEN. Which items involved in ship construction now are we solely dependent on foreign sources for?

Mr. KISS. For the most part, they are what I would call noncritical items, things such as binoculars, manual typewriters. There's a device called a clearview screen, which essentially serves the same purpose as a windshield wiper on a ship. It's a rotating window. Those are the items for which we have become solely dependent on foreign sources.

Senator JEPSEN. I understand that we don't make large anchor chain; is that correct?

Mr. KISS. We have not had a commercial need for the anchor chain in the size that is unavailable in the United States since we have stopped producing the ultra-large crude carriers in the mid-1970's.

Senator JEPSEN. In your studies of our capacity to mobilize ship

regular repair and construction in the event of an emergency, where do most of the serious bottlenecks occur?

Mr. KISS. Most of the bottlenecks that we would anticipate would be in lead times on main propulsion machinery. For steam turbine plants, it would probably be the gears, although it could also occur in the turbine area itself.

The bottleneck itself, where it would occur, would depend largely on what kind of ships the Navy were producing at the same time and what their demands were and how they interfaced with their demands for similar components from merchant ships. Large castings and forgings would also probably be a bottleneck in a surge situation.

Senator JEPSEN. Recent changes in the law allow U.S. carriers to receive operating differential subsidies for ships constructed overseas in the case of construction differential subsidy funds not being available. How much construction differential subsidy funding was provided in the budget for fiscal year 1982, do you know?

Mr. KISS. As far as I know, zero.

Senator JEPSEN. For the record, would you have that doublechecked and submit it?

Mr. KISS. Yes.

Senator JEPSEN. Do you anticipate any funds being appropriated for the cost differential subsidies in 1983 and later?

Mr. KISS. We have requested funds. I don't know what the final action will be on that. I might add also that in fiscal year 1982, although I believe the appropriation was zero, we had a carryover of some approximately $37 million from the previous year.

Senator JEPSEN. I just asked for you to put it in the record. Our information shows that there was $1 million provided in the budget for fiscal year 1982. And I don't know if appropriations have been made. But these are some of the things that we're working on now.

Mr. KISS. Yes, sir.

[The following information was subsequently supplied for the record:]

No CDS funding was provided in the budget for fiscal year 1982.

Senator JEPSEN. We've a continuing resolution and some of the appropriations haven't been made. So I can understand how it would be very easy not to be sure. In fact, I'm not sure that my information is accurate.

What I was getting at primarily is that it does seem that the operating differential subsidy will cease being a very strong incentive for U.S. carriers to have ships built in this country. Does that make sense?

Mr. KISS. Well, the construction differential subsidy, if it is not appropriated, will no longer be an incentive to build ships here.

Senator JEPSEN. Do you view that as a problem?

Mr. KISS. It may be a problem. As I mentioned in my prepared statement, the administration is developing a comprehensive maritime policy and I'm sure that it will look very closely at the shipbuilding segment and hopefully, offer an alternative or a method to assure that that segment is treated fairly and adequately.

Senator JEPSEN. Do you have any additional statements or anything that you would like to have submitted in the record at this time? The record will show that we'll keep it open until the close of business tomorrow. If you have anything further at this time——

Mr. KISS. I have nothing further to add, Mr. Chairman.

Senator JEPSEN. The Jones Act provides that all ships built for protective domestic use in the United States be built in the United States. Since some of the domestic ships could also be used to carry cargo overseas, this regulation does benefit the American seagoing shipbuilding industry. Are you supportive and in favor of reinforcing that and making sure that continues?

Mr. KISS. Yes, I think that we would very much like to see that continue. In the recent past, that has been instrumental in construction of a number of handy-size tankers which would have a very important role in defense shipping.

Senator JEPSEN. I thank you. I have no further questions at this time. There may be more, as I say, submitted for the record. Please don't hesitate to submit any information that you feel will be helpful as we build our files and research and study this most important area of preparedness, readiness, and surge capacity, and it's a serious problem.

Thank you very much.

Mr. KISS. Thank you. We'll do that.

Senator JEPSEN. Thank you very much for coming. The subcommittee is adjourned.

[Whereupon, at 4:15 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

Response of Hon. Fred C. Ikle to Additional Written Questions Posed by Senator Jepsen

THE UNDER SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

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POLICY

08 JAN 1982

In Reply Refer To:
I-16296/81

Honorable Roger W. Jepsen
Chairman, Subcommittee on Monetary
and Fiscal Policy
5327 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

I am pleased to respond to your letter of December 21, 1981, in which you asked for written answers to ten questions for inclusion in the record of the recent hearing on the defense industrial base. The questions and answers are attached.

It was a privilege to meet with you and the members of the Joint Economic Committee. I will be happy to provide any additional information you may require.

Sincerely,

Fred C. Ikle

Attachment
a/s

QUESTIONS AND ANSWERS FOR HEARING RECORD

Joint Economic Committee

Subcommittee on Monetary and Fiscal Policy

December 9, 1981

1. Question. How does the Department of Defense determine which items, such as subcomponents and refined materials, are critical in the production of a given weapons system or other contract item?

Answer. Our Industrial Preparedness Program requires selected contractors, through the use of sub-contractor planning procedures, to identify critical pacing sub-components and refined materials. In addition, in special cases we perform sector analyses when such items are used by several systems or end items. Another source of data are our periodic meetings with industry associations and defense contractors.

2. Question. Would you provide some specific examples of cases in which Defense acquisitions have been restricted to a domestic supplier in order to preserve a domestic source for a given item?

Answer. Some specific cases in which Defense acquisitions have been restricted to domestic suppliers to ensure a domestic source for surge or mobilization needs are:

(a) Precision ball bearings, 30mm and smaller;

(b) Chaff used to prevent radar detection and missile lock-on;

(c) AIM-7 missile critical items;

(d) Large gun barrels; and

(e) Nearly all of our munition items.

3. Question. When a domestic source is maintained by directing acquisitions to a domestic supplier, is the goal to preserve surge capacity or merely to ensure that a peacetime level of production can be maintained in the event of interruption of foreign sources for the item?

Answer. When we direct our acquisitions to maintain a domestic supplier, the objective is to retain a capability to meet specific surge or mobilization requirements.

4. Question. The General Accounting Office (GAO) recently criticized the industry data base maintained by the Departments of Defense and Commerce in a letter to those agencies dated September 15, 1981. The GAO criticized the quality of the available information on the foundry industry in light of the rising number of closings over the past 25 years.

Since it is vital to have an adequate data base for formulating policy, how would you respond to this criticism?

Answer. We have taken an initial look into the situation presented in the GAO's letter report on the foundry industry and there appears to be little or no impact on direct Defense needs, either peacetime, or surge or mobilization. As the GAO pointed out, however, the foundry data are not up to date. A more detailed analysis of requirements versus capability seems desirable. Therefore, in coordination with the Department of Commerce, we intend to gather more comprehensive information on the foundry situation. Our review should be completed in about 6 months.

5. Question. The industrial preparedness program has come under frequent criticism in GAO reports over the past few years, the last report having been issued in May. How would you assess the current effectiveness of the IPP in providing accurate information on our domestic mobilization capacity?

How much manpower and resources does the Department of Defense currently dedicate to the program?

Are there any policies or plans underway to assign the program a higher priority?

Answer. In the past, we have experienced some deficiencies and lack of effectiveness in the Industrial Preparedness Program, due primarily to our inability to fund industrial preparedness measures identified by the Military Services and industry. Recently, however, higher priorities and more resources have been afforded this effort. Our current FY 1982 funding levels for the Industrial Preparedness Program total $838 million, an increase of $100 million over the previous Administration's budget. Our FY 1983 budget will increase the total program to $1.164 billion. Additionally, the Military Services now allocate about 600 people to the Industrial Preparedness Program, more than 100 persons over the past year.

We believe we have now assigned the proper priority to the Industrial Preparedness Program. To effect implementation we are completing revision of the Department of Defense Directives and Instructions which provide comprehensive guidance to the Military Services and the Defense Logistics Agency. When this

has been done, about two months hence, our program will be in full gear.

6. Question. The creation of a Defense Policy Advisory Committee could be the answer to a concern expressed by all the witnesses at our September 30 hearing, that is, better communication between government and industry as policy is formulated. Who will determine who will best represent the interests of the various industries? Will there be a representative of small business interests?

Answer. Dr. Richard D. DeLauer, the Under Secretary of Defense for Research an Engineering, in coordination with the U.S. Trade Representative, is currently reviewing industry candidates for the Defense Policy Advisory Committee. The candidates being considered represent a wide range of defense industries. Representation by small business concerns will be an important part of the committee. The list of actual members can be made available when formalized in 60 to 90 days.

7. Question. How dependent are we on overseas producers of metal fasteners? Are any programs being contemplated to ease our dependency on foreign sources?

Answer. More than 50 percent of all fasteners used for defense and commercial purposes in this country are imported. Current domestic capability is not adequate to meet projected mobilization needs, and industry is doing only a limited amount of facilities modernization.

In early January 1982, we plan to ask the Department of Commerce to conduct an investigation under Section 232 of the Trade Expansion Act of 1962. This investigation, which will require about one year to complete, will determine the national security impact of our dependence on imports, and will recommend actions to be taken to ensure a domestic capability. The Department of Defense will play a key role in the investigation.

8. Question. Many of the industry representatives at the September hearing maintained that many foreign industries having received lavish assistance from their governments, in the form of subsidies, accelerated depreciation schedules, loan guarantees, etc., and that U.S. firms, especially capital intensive ones, cannot compete successfully in this environment. They perceive the continued erosion of many defense-related industries as inexorable. How do your perceptions differ?

Answer. The considerable foreign government assistance being given to increase the marketability of foreign defense exports has created problems for our defense industries. Many other factors also contribute to our declining competiveness, most

notably, lack of stability in defense-related business. Others include foreign manufacturing technology advances, lagging U.S. productivity, disparity in environmental protection restricions, and relatively high U.S. labor costs.

Steps are being taken to address some of these deficiencies. New depreciation allowances have already been approved. Multi-year procurement also has been adopted recently to provide more stability to selected programs. We in Defense are working with industry by sponsoring the development of advanced manufacturing techniques, providing new capital investment incentives, adding risk indemnification initiatives, reducing red tape, and taking other steps to add more stability to the acquisition process. These actions will take time to become effective, but they should result in a more competitive, and therefore, more viable, defense-related industrial base.

9. Question. I would like to ask a more general question. You are no doubt aware of the Ichord hearing held on the industrial base late last year. The findings from these hearings have provided the basis for this and other hearings. How would you assess the validity of the Ichord Committee findings?

Have there been any significant changes in the state of our industrial base in the year since the hearings?

Answer. The Ichord hearings were very informative and one of the best overall reviews of our industrial base Congress has conducted in recent years. However, they may have overstated some problems that should have been more accurately portrayed as snap shots of the 1979-80 situation and not as generic shortcomings of industry. An example would be lead times, which peaked in those years and have been considerably reduced since. In any regard, the Ichord hearings served to focus attention on industrial base problems and to stimulate much needed changes. Several areas are already being acted upon by Congress and Defense such as tax law changes for capital investment, termination liability limits, multi-year contracts and increased funding of manufacturing technology projects. Additionally, Defense has greatly increased its emphasis in the Defense Guidance on industrial preparedness measures.

Over the past year, as noted above, there has been a substantial reduction in lead times at the vendor and supplier level. This may have been caused more by a decline in commercial orders than by increases in manufacturing output. However, we believe that if lead times remain short, more deliveries will be made on time, thus stabilizing production rates on major system acquisitions. In addition, we have observed in many industrial sectors, a growing interest in seeking out defense related work. This translates into more competition, and ultimately, more efficient

procurements and increased mobilization capabilities.

10. Question. Dr. Ikle, you have personally advocated for many years that Defense funds be programmed specifically for strengthening the defense industrial base. You have written that this would mean a great deal to our deterrence of a conventional war. Do you feel that significant funding for strengthening the industrial base can be made within the framework of the programmed 7 percent increases in Defense spending?

Answer. The programmed 7 percent increases in Defense spending are not considered to constrain our efforts to strengthen the defense-related industrial base. The FY 1983 budget figure of $1.164 billion for the Industrial Preparedness Program attests to the emphasis we can place on this effort within current budget guidelines.

Strengthening the industrial base has never been viewed as requiring massive infusions of capital or large subsidization programs. What has been needed is a combined program to remove the many disincentives associated with defense procurements, and, at a the same time, to provide modest funding to encourage new initiatives in defense-related production. We are embarked on just such a program now.

Response of Ronald K. Kiss to Additional Written Questions Posed by Senator Jepsen

U.S. Department of Transportation
Maritime Administration

Administrator

400 Seventh Street, S.W.
Washington, D.C. 20590

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JAN 27 1982

The Honorable Roger W. Jepsen
Chairman, Subcommittee on
Monetary and Fiscal Policy
Joint Economic Committee
United States Senate
Washington, D.C. 20510

Dear Senator Jepsen:

Thank you for your letter of December 21, 1981, requesting the Maritime Administration to submit additional information supplementing Mr. Kiss' testimony on America's defense industrial base before your Subcommittee on December 9.

Enclosed are our responses to the six questions posed by the Subcommittee. I believe that these responses fully address your interests in the specific matters being considered. We stand ready to submit additional information if desired.

Again, thank you for the opportunity of presenting the Maritime Administration's views on the Nation's industrial base to the Subcommittee on Monetary and Fiscal Policy.

Sincerely,

H. E. Shear
Maritime Administrator

Enclosures

Question No. 1:

Last May the General Accounting Office (GAO) released a report on the deficiencies of the industrial preparedness program (IPP).

Do you agree with the conclusions contained in the report? What steps need to be taken to make the IPP more effective as an accurate data base of planned procedures?

Answer:

The Maritime Administration agrees in general with the contents of this report and feels that GAO's analysis and findings warrant our attention. This agency is cooperating in actions initiated by the Department of Defense in alleviating the deficiencies cited by the GAO. We feel that a national policy and intention has been finally addressed at all levels of the Federal Government to ensure industrial responsiveness, and that Congress and the Executive Branch have taken the leadership and given the direction that is required. Past attitudes of tolerance and apathy towards the IPP program are beginning to be changed to that of support, acceptance, and renewed emphasis.

In particular, we have been assisting DOD in the revision of guidance and procedures which will make the program more responsive to our needs. New directives have been formulated and should be in use by early 1982. Within the framework of our program, we have initiated comprehensive analyses of critical sectors of the shipbuilding industrial base to assess their ability to satisfy our logistics requirements during a national emergency. In addition, during FY 1981, we expanded our planning efforts at the sub-tier levels.

Question No. 2:

You indicated that the special provisions of the slow speed diesel program allows 50 percent use of foreign components in the initial manufacturing period. Are you assisting the manufacturers to find domestic suppliers of components that are currently imported? If so, how?

Answer:

Maritime Administration slow speed diesel policy, as stated in Docket A-118, dated August 12, 1977, and published in the Federal Register on August 26, 1977, (42FR43112) allows "a reasonable percentage" of foreign components in initial engine units built in the United States. The policy originally considered allowing a threshold percentage of 60 percent foreign for initial units but modified the policy to "a reasonable percentage" to avoid possible arbitrariness. The 60 percent figure (60% foreign, 40% domestic) is still the foreseeable outside limit and is continued as a goal.

The Maritime Administration does not have access to detailed material specifications and shop drawings for slow speed diesel components, and thus does not attempt to locate U.S. suppliers for specific items. We prefer to identify engine components which appear to be available in the U.S. and then direct the attention of engine manufacturers toward potential U.S. suppliers. Only one slow speed diesel engine project involving construction-differential subsidy has come to fruition. During that project, we carefully monitored the foreign/domestic

component mix for the engines under construction and based on the experience, actively worked with the engine manufacturer to decrease the use of foreign components for future engine orders. Also, as potential U.S. sources for components become known to us, the information is passed on to the engine manufacturers. One particular instance of the foregoing involved engine component castings. Through our efforts, slow speed diesel manufacturers were acquainted with the specific capabilities of U.S. foundries, and it is expected that the next order of U.S.-built slow speed diesels will utilize domestic castings.

Question No. 3:

Are you familiar with the Ichord hearings held on the industrial base last year? The information generated at these hearings has been the basis for this hearing and many others as well. What is the Maritime Administration's position on the findings that resulted from the Ichord hearings? How do you feel the situation has changed in the last year?

Answer:

The Maritime Administration is familiar with the recent Ichord hearings on the industrial base. We feel that the report was very informative and seemed to focus attention on industrial readiness and to stimulate change. However, it is our opinion that many of the deficiencies cited were overstated, should have been more accurately portrayed and did not relate to the shipbuilding industrial base. Some problems such as extended leadtime were perceived as being long-term, when in reality they were peculiar to the 1979-80 period of high commercial demand in many defense-related industries such as aerospace.

New initiatives such as tax law changes and improvements in manufacturing technology (MANTECH) programs have been recently undertaken to assist in alleviating some of the deficiencies cited by the Ichord panels and will indirectly benefit Maritime Administration programs. Other corrective actions such as multi-year procurement are not of particular interest to this agency but may stimulate the industrial base in a positive way.

Question No. 4:

What was the background of the recent decision to alter the cost-differential subsidy/operating-differential subsidy program?

Answer:

The new Section 615 of the Merchant Marine Act, 1936, as amended, grants temporary authority to permit operating-differential subsidy (ODS) applicants or recipients to construct, reconstruct or acquire vessels abroad in the absence of sufficient construction-differential subsidy (CDS) funds for such purposes. Prior to enactment of Section 615, only U.S. built vessels were eligible for ODS.

Section 615 was enacted due to the lack of new CDS funding in fiscal year 1982, and to the possibility that funding may be at a level insufficient to fund projects proposed by U.S. operators in the succeeding year. Due to the substantial c t disparity between building vessels in U.S. shipyards and building abroad, it is not economically feasible for operators engaged in the foreign trade to upgrade and modernize their fleets in U.S. shipyards without CDS. Section 615 thus permits these operators to build or rebuild vessels abroad if CDS is not available.

Question No. 5:

You have mentioned that you are conducting a study of the operating-differential subsidy program. What are the criteria that you will be reviewing in connection with this study?

Answer:

The operating-differential subsidy (ODS) program study which is currently underway at the Maritime Administration is intended to provide a comprehensive review of all aspects of program administration. We are endeavoring to improve the program in order to assure it is effective and useful in carrying out the purposes of the Merchant Marine Act. We are reviewing such aspects as ODS payments, accountability, and control. Changes in procedures, regulations or statutes which appear to offer opportunity to achieve our objective of improved program administration will be proposed as appropriate.

Question No. 6:

You have stated that there is a 50 percent ad valorem tax on ship repairs conducted overseas on American-built ships that are eligible for operating-differential subsidies. Does this ad valorem apply to foreign-built ships receiving the operating differential subsidy as well?

Answer:

The ad valorem applies to foreign repairs for all U.S.-flag vessels regardless of where built or whether receiving operating-differential subsidy (ODS). The construction of commercial vessels built abroad for U.S. flagging is specifically exempted from the ad valorem tax. Also exempted from the tax is the cost of major alterations to a commercial vessel. Therefore purchasing a new or reconstructed foreign vessel for U.S. flagging would not result in paying the 50 percent tax. Once in commercial service, however, the U.S.-flag vessel would be subject to the payment of ad valorem for repairs performed abroad.

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